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The Investment Dealers Association of Canada

Hearings held at

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Wednesday,
July 11th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Wednesday, July 11th, 1962.

--- At 8.45 A.M. the hearing commenced.

SUBMISSION OF THE INVESTMENT DEALERS'

ASSOCIATION OF CANADA

APPEARANCES

Mr. D. S. Beatty	- President, The Investment Dealers' Association of Canada.
Mr. Gerald D. Sutton,	- Nesbitt, Thomson and Company Limited
Mr. Andre Leman	- Geoffrion, Robert & Gelinas Co. (Substituting for Mr. F. L. Glasgow, Royal Securities Corporation Limited)
Mr. Clark Kinnear	- W. C. Pitfield & Company Limited
Mr. Harry L. Gassard	- General Manager, The Investment Dealers' Association of Canada
Mr. William Harris	- Harris & Partners Limited
Mr. Noel Fowler	- James Richardson & Sons (Substituting for Mr. N. J. Alexander, James Richardson & Sons)
Mr. J.G.K. Strathy	- Dominion Securities Corporation Limited (Substituting for Mr. T.P.N. Jaffray, Dominion Securities Corporation Limited
Mr. Alec Adamson	- Clarkson Gordon & Co.
Mr. D. Bruce Shaw	- A. E. Ames & Co. Limited
Mr. Edward H. Ely	- Wood, Gundy & Company Limited
Mr. Grahame Johnson,	- L. G. Beaubien & Co. Limited
Mr. Arthur J. Milner	- Mills, Spence & Co. Limited
Mr. Roland B. Dodwell	- Secretary, The Investment Dealers' Association Brief Committee
Mr. George Cretzianu	- Greenshields Incorporated

Mr. Murray D. Cox	- Anderson & Company Limited
Mr. Howard W. Hunter	- Burns Bros. & Denton Limited
Mr. R. W. Wadds	- McLeod, Young, Weir & Company Limited

THE CHAIRMAN: Call the meeting to order.

This morning we have a submission from The Investment Dealers' Association. We have all read the brief that has been filed with us and some, at least, of the supplementary material which has been supplied from time to time and I wish on behalf of the Commission to express our appreciation for the brief and the manner in which it has been prepared. It is quite obvious that a tremendous amount of thought and a great deal of work has been put into this submission and we find it very helpful indeed as it applies to the various matters which are of interest to us.

I would expect that it will result in quite a lengthy discussion throughout today and possibly tomorrow so that we may now proceed.

Mr. Milner?

MR. MILNER: Thank you, Mr. Chairman and members of the Royal Commission.

In preparing its brief to the Royal Commission on Banking and Finance, The Investment Dealers' Association of Canada has endeavoured to concentrate its attention on matters which it considers to be of national importance. The recommendations and suggestions derived from its investigations are confined solely to matters which

it feels to be in the best interests of Canada.

A complete list of the draft recommendations of all committees was distributed to each member firm and the draft summary, together with the supporting evidence, was also made available to members. All members were invited to attend a two-day meeting commencing on May 7th, 1962 to consider these recommendations. This meeting was attended by some 80 members and resulted in eliminating, re-writing and adding recommendations.

As you can see from the brief there were some changes made where we deleted certain paragraphs.

As a result of this, we feel that the recommendations of this brief truly represent the thinking and opinion, but not necessarily unanimous, of members from coast to coast.

To clarify the Association's recommendations, I would like to point out to the Commission the distinction that is intended between the three types of expression used. Where a recommendation is definite, the form "that something be done" is used. Where a suggestion is being advanced to the Commission, the form "that the Commission consider" is used. Where, due to lack of sufficient knowledge or evidence, the Association has not felt itself competent to recommend or suggest action on a subject considered worthy of being brought to the Commission's attention, the form "that the Commission examine" has been used.

Several matters have come up for discussion that appeared to relate primarily to the internal operations of the Association or to its relations with other financial

associations. These matters have been intentionally left out of the brief because, in our opinion, they were family problems capable of solution by co-operative action.

This brief has been prepared on a committee basis and although the changing of the hearing from September to July has made it impossible for some of our committee chairmen to be present, we are fortunate in having most of them here. If it is agreeable to the Commission, I would prefer that the questions be addressed to myself and then I will be in a position to refer them, where necessary, to the member of my committee who is in a position to speak most competently on the subject concerned.

May I take this opportunity of introducing the chairmen of the various committees who are with me today.

Mr. D. S. Beatty, President, The Investment Dealers' Association of Canada

Mr. Roland B. Dodwell, who has acted as Secretary to The Investment Dealers' Association Brief Committee

Mr. Harry L. Gassard, General Manager, The Investment Dealers' Association of Canada

Mr. Alec Adamson, Clarkson Gordon & Company, an Association Auditor whose firm compiled the statistical data as to sales, etc.

Mr. Edward H. Ely, Wood, Gundy & Company Limited - and

Mr. R. W.Wadds, McLeod, Young, Weir & Company Limited - Finance Department and Federal and Provincial Finance

Mr. Murray D. Cox, Anderson & Company Limited -- Bank of Canada

Mr. Grahame Johnson, L. G. Beaubien & Co. Limited -- Municipal Finance

Mr. Gerald D. Sutton, Nesbitt, Thomson and Company Limited -- Corporation Finance and Legislation

Mr. Howard W. Hunter, Burns Bros. & Denton Limited -- Secondary Bond Market

Mr. William Harris, Harris & Partners Limited -- Short Term Money Market

Mr. D. Bruce Shaw, A. E. Ames & Co. Limited --Chartered Banks and "Near Banks"

Mr. Clark Kinnear, W. C. Pitfield & Company Limited -- Retailing Stocks and Bonds and Risk Capital

Mr. George Cretzianu, Greenshields Incorporated -- Stock Business

Mr. Noel Fowler of James Richardson & Sons, Substituting for Mr. N. J.Alexander of James Richardson & Sons -- Mutual Funds

Mr. Andre Leman, Geoffrion, Robert & Gelinas Co. -- Substituting for Mr. F. L. Glasgow, Royal Securities Corporation Limited -- Financing Small Business

Mr. J. G. K. Strathy, Dominion Securities Corporation Limited, Substituting for Mr. T. P. N. Jaffray, Dominion Securities Corporation Limited -- Taxation

Unfortunately, Mr.Harold Robertson, Mills, Spence & Co. Limited -- Non-Resident Investment -- is unable to be with us today.

That is the panel we have with us today, Mr. Chairman.

THE CHAIRMAN: Thank you. That is all you wish to submit at the moment?

MR. MILNER: That is all.

THE CHAIRMAN: So that we may now proceed with the questions.

COMMISSIONER LEMAN: Mr. Chairman -- by the way, sometimes we have heard, depending on the acoustics of the room, that some of the people in the audience cannot hear very well so I think we will all have to make sure that our voices are raised high enough so that everyone can hear us. If anyone at any time does not hear any one of us, and particularly me, please raise your hand and I will make sure to raise my voice.

Your interesting brief from the beginning gives us a good history of the industry and while we might all think that we know what an investment dealer is, I wonder if it would be possible for the record to have a short catechism type of definition of what is an investment dealer and what his main functions are and what good he does for the economy. Could you supply us with a broad definition?

MR. MILNER: I think, Mr. Leman, I will have Mr. Gassard, our Association Managing Director, answer that.

MR. GASSARD: Mr. Commissioner, I would say that the investment dealer is primarily a merchant who performs both the function of an agent and the function of a principal and in performing these functions he plays a role in mobilizing capital and we have to direct

[illegible]

it into socially and economically approved projects. In other words, he is a mechanism for moving capital about. He also plays a role in the decisions that result in the application of capital under our market system.

COMMISSIONER LEMAN: Does that contain all the basic distinctions that characterize the industry? There are other types of institutions who do that too, are there not?

MR. MILNER: Well, Mr. Leman, I might go further to say that we have 190 odd members in our Association and the figures we submitted on the volume of the secondary market operations and other phases of our industry tend to show that as an industry we are divided really into two parts. There are some 30 to 35 firms who are primarily both jobbers and underwriters -- jobber-underwriters and also deal retail at the same time; in other words, one of our large national houses has offices right from Halifax to Vancouver, but those offices of theirs together with the other remaining 160 odd members are primarily dealing with the public either as members or as principals or as agents. The main underwriting is done by this relatively small number of our members. Is that what you wanted?

COMMISSIONER LEMAN: Well, that touches the subject a little bit. Perhaps we can do with that definition, it always helps. Part of the definition, the distinctive feature that was mentioned was the moving of capital to those who can use that capital. Banks do that too, do they not?

MR. MILNER: Yes, a bank has the same function as we have but our industry covers so many phases of the financial business and there are so many specialists in the field, that is, some of our firms specialize in money market securities more than other securities. Some specialize in the sale of mutual funds going to the other extreme and the Association is so complex in its makeup. We have, as you are well aware, a number of what might be called purely stock exchange members who are members of both the stock exchange and our Association. So that to give a specific description of our industry I think is almost impossible.

COMMISSIONER BROWN: I think one of the things that is possibly being looked for, Mr. Milner, is the question of providing a market for the fixed income securities and by the provision of such market the industry thereby makes such instruments possible.

MR. MILNER: Well, Mr. Brown ----

COMMISSIONER BROWN: It is not only the accummulation of this capital or the provision of it to industry; it is also the provision of the secondary market, and this is what differentiates the bonds and debentures from mortgages -- the marketability.

MR. MILNER: I will ask Mr. Hunter to answer that second part.

MR. HUNTER: Mr. Commissioner, I think we have been probably dwelling on the primary market aspect of things up to now. The secondary market is an area which has been developed for the resale of securities which were originally distributed. People who have

bought securities with the intention of holding them find the necessity of selling them suddenly and we, through our vast trading departments, provide the means whereby they can dispose of their holdings and other people who, at the time of issue, were not prepared to buy for one reason or another have an opportunity of coming to the market and having their securities and this does supply the liquidity which is necessary to encourage people to participate in the capital market.

COMMISSIONER BROWN: That is the point I wanted to bring out.

COMMISSIONER LEMAN: Would you say, Mr. Milner, that there were 30 firms that you would class as more wholesale types of firms and the balance would be more primarily engaged in retail work?

MR. MILNER: Well, Mr. Leman, we had these industry figures prepared which the members submitted to Clarkson Gordon who are the Association's auditors and they combined all the figures into an industry figure, but in combining those figures we got them to break it down and we took an arbitrary basis on breaking it down -- this is on the secondary market operations -- and the arbitrary basis that we took was taking last year by quarters, each quarter of the last year, the number of firms that had an average inventory of $1 million or over during the entire year of 1961 and there were 33 member firms that had that size of an inventory. I am not saying how big the largest one was, I am merely saying that is where we broke it off. You must

remember we were most anxious not to have a double set of figures. You will be hearing the Montreal and Toronto stock exchanges some time later and we combined with their organizations so that the firms that report, some 60 of our firms are reporting through the stock exchange as a member to the Investment Dealers' Association -- am I right, Mr. Adamson? -- about 125 of the firms reported in this group and the pure stock firms reported to the stock exchange so there is no duplication of figures, We hope there is not anyway.

COMMISSIONER LEMAN: In paragraph 37 of Section A you have broken down the groups into three types. You call the first type the integrated house, the second type the distributing house, and the third type you say are specialty houses that are specialized and confine their operations to a narrower field. Have you got the number of firms of each type? That was paragraph 37, section A.

MR. MILNER: I am going to ask Mr.Gassard to answer that.

MR. GASSARD: Well, Mr. Leman, this would be an estimate because there is a great deal of overlapping and you have to allot firms arbitrarily but by far the larger group would be the distributing houses. We have 191 members and of these we designate 32 as major positioning houses and those would include all the integrated houses so just as an off the top of my head guess I would say there is probably 15 specialty houses and perhaps 15 to 20 integrated houses and the balance might be more accurately described as distributing

houses. But even that classification is subject to debate because our business is a sort of ad hoc business and as conditions change you will find that people who do not ordinarily get into the municipal business will become more active in municipals. I would say the great majority of our 191 member firms are distributing houses.

COMMISSIONER LEMAN: And, of course, a firm could move from one classification to another.

MR. GASSARD: Yes.

COMMISSIONER LEMAN: As a matter of fact, why are they in those particular groups? Is it purely a matter of choice or is it the way they are equipped with capital or personnel or what are the basic characteristics of, say, an integrated house? Would it be from the point of view of the capital available to them or the amount of personnel available to them and the other types -- what distinguishes them?

MR. MILNER: Mr. Leman, that is a very broad question to ask.

The capital requirements that we have instigated in our association were primarily designed to protect the public against any possibility of loss being suffered through dealing with any one of our member firms.

A small local house in Regina does not need the same capital that a large house in Toronto or Montreal needs. The limitations on their business does to some degree depend on their capital because we have very strict regulations as to how much inventory or how much liability firms can carry in relation to their working capital. It is a very complicated system of auditing our members so as to be sure they are all solvent at all times. In answer to your question in regard to specialization, some firms have found it simpler to specialize, I would not say necessarily because they have not got sufficient working capital to follow the other method, but I think it would be fair to say that it has great limitations on the amount of capital related to how much business they can do.

COMMISSIONER LEMAN: Does the specialization give a firm an advantage in that particular field?

MR. MILNER: I would think so, yes, if they specialize in that field. Take, for instance, the firms that want to specialize in the day-to-day market on short-term money; firms for instance such as Traders Finance, I.A.C., General Motors Acceptance and Simpson-Sears, etc., require practically no working capital

because their business is done completely without liability; they are acting as straight agents and are paid a commission. Therefore, there are people who specialize in that they would not necessarily guarantee their large positions in the short-term government field.

We have a number of smaller firms which do a very large amount of business in what we call commercial paper.

COMMISSIONER LEMAN: There are no firms that are specializing in a type of business that the integrated houses do not do? It is not that type of specialization you refer to?

MR. MILMER: No,the integrated houses cover the whole field as best they can. Our integrated houses attempt to cover the whole field of business.

COMMISSIONER LEMAN: I ask these questions, Mr. Milner, because your industry in a sense is difficult to analyze for one who is not in it, because so far as I know there are not very many, or perhaps there are not any firms among your 191 members who publish statements.

MR. MILNER: The only member we have which publishes a financial statement is Merrill Lynch, and it only publishes its American financial statement, not the Canadian.

COMMISSIONER LEMAN: This business of publishing statements is more prevelant in the United States, is it not?

MR. MILNER: No, there are very few in the United States which publish. The Boston houses have to publish statements because they have limited stock

publicly owned. A number of members of the New York Stock Exchange publish a balance sheet, but I know as a matter of fact that any person can demand a statement from a member of their stock exchange.

COMMISSIONER LEMAN: That is in the United States?

MR. MILNER: That is in the United States, yes.

COMMISSIONER LEMAN: We do not have that regulation here?.

MR. MILNER: We do not have that regulation here either in our end of the business or the stock end of the business. That is, members of the stock exchanges in either Montreal or Toronto are not required to submit statements to the public.

COMMISSIONER LEMAN: I wonder why there is this reluctance to publish statements in Canada?

MR. MILNER: I think that is a very easy thing to answer. We are all private companies. There is no public interest in any of the finance companies in Canada. The finace companies, such as our members, have carried on over a period of years in the same way. I think I am right in saying that. There are no statements issued, for instance, by members of the London Stock Exchange. They never publish annual statements in respect to either their profit and loss or their working capital positions. We are not public companies in the same sense that the banks are, or the insurance companies which are publicly owned and therefore of necessity must publish statements.

COMMISSIONER LEMAN: I realize that, but I am just wondering what harm it would do. You see, we heard from a group, I think it was the Security Analysts of Toronto, and they came before us and made quite a good presentation of the value of the corporation industrial companies etc., from an investment point of view in making a lot of financial information available to the public. I can understand from an investment standpoint why that would be so useful, but in turn I wonder if it might not help the public a little bit sometimes if they knew who they were dealing with for certain types of business they do with the investment dealers.

MR. MILNER: Frankly, Mr. Leman, we do not see any advantage in that. We think that our own internal audit system, or the association audit system is as foolproof as it is possible in so far as keeping our firms solvent, which is the one thing that would worry us tremendously. That is, if we had a failure of one of our members who was not able to meet his obligations. Our position is such that we are large borrowers from the chartered banks, and the chartered nanks do not lend money freely without proper security, so that we just do not see any advantage in publishing financial statements.

MR. GASSARD: The Analysts' brief only referred to those corporations whose securities were in the hands of the public, not private companies. I think your argument would be more valid if our members' securities were owned by the public.

THE CHAIRMAN: Your underwriting end of the business is to distribute securities of other companies than your own which are generally public companies?

MR. MILNER: Public companies.

THE CHAIRMAN: I suppose a customer has no particular interest in what your financial position is, is that the position you take?

MR. SHAW: That is the position we take.

COMMISSIONER LEMAN: I suppose if a corporation was going to make an arrangement with you of the underwriting type he could ask to see the financial statement in order to see how responsible a firm he was dealing with?

MR. ELY: It has never been the practice.

MR. BEATTY: I have never known this to happen, but I have known of corporations to ask a bank to guarantee payments on an underwriting commitment for which the dealer has paid a fee and has to re-assure the bank of his ability to meet the commitment.

COMMISSIONER BROWN: Perhaps you might outline in a little more detail the standards the association imposes upon its members in order to ensure protection to the public; the number of audits per year and the number of reports per year which must be made?

MR. MILNER: Mr. Adamson, would you answer that? Mr. Adamson is our association auditor in Ontario.

MR. ADAMSON: The members are required to report twice yearly to us on their financial positions. We get financial statement twice yearly; one an audit statement and the other a statement prepared by the member

himself.

COMMISSIONER BROWN: I was thinking perhaps you would go further and explain what the regulations are and what happens if you find that the regulations are not being met.

MR. ADAMSON: There are certain capital requirements. We have a formula for establishing capital requirements. In submitting a statement to the association auditor a member is required to calculate what his capital is and how it measures up against the regulations; whether there is an excess or deficiency, and if there were a deficiency in the capital we auditors would do something about it right away.

MR. MILNER: I will also ask Mr. Gassard to give the actual procedure of the method of operation when this situation occurs.

MR. GASSARD: The association is concerned mainly with three basic qualities. First, the financial competence and capital; secondly, the nature of the business and, thirdly, the conduct and experience of those who conduct the business. Our financial by-laws operate on the basis of district auditors who examine financial statements periodically. The association approves of a panel of auditors from which the member firms may select their own auditors. These auditors periodically deposit with the district auditors, such as Clarkson-Gordon, a financial statement on four forms, which are deposited with the commission as part of our exhibit. As Mr. Adamson pointed out, these statements are based on a margining formula which

requires the firm to have enough capital to margin its outstanding commitments; for instance, the inventory against possible declining value, the receivables and future commitments.

This formula took about three years to work out and we are indebted to Clarkson-Gordon for working on it.

It is very flexible and it enables a small firm whose capital and whose business does not need so much capital, to get by on our present minimum of $25,000. It requires a larger firm -- an integrated house -- to have vastly more capital. If the district auditor is disturbed with any condition that is developing in the firm's financial position the chairman of the district has a confidential audit committee to which the district auditor can turn and discuss a member firm by number. The auditor has very wide powers in this connection. The audit committee is also comprised of senior auditors who have had years of experience in both good times and difficult times which matures their judgment.

The by-law also provides that if the situation is sent to the audit committee and the auditor is dissatisfied it will be taken to the district committee.

That is the financial by-law.

COMMISSIONER LEMAN: There are insurance requirements as well?

MR. GASSARD: There are insurance requirements and requirements as to proper sets of books with

segregation of financial securities properly earmarked, and segreation of clients' credit balances.

The formula under which we operate, which is known as the regulations under by-law 8 A, provides that if a firm places so much capital in the business they can conduct a margin business.

The impression I want to leave with the Commission is that this is a flexible by-law because, as Mr. Milner pointed out, there are 191 firms, no two alike, so our by-laws have to meet different situations and meet different marketing conditions.

MR. MILNER: I might add, Mr. Leman, I think you asked the question -- no, Mr. Brown, I am sorry -- that our by-law regulations, the same as the stock exchange by-laws, do require members, not only at the period of audit, but at all times, to be in a capital position sufficient to meet all liablities, and if a situation develops where a firm gets over-committed in between the audit periods we have a means of subrogating additional capital until the firm recovers from that particular difficulty. This could be from the situation that they have merely taken on something too large for their capital requirement and when that situation is over they are permitted to withdraw that capital and go back to where they were.

COMMISSIONER BROWN: Do we gather from that that the auditor at the end of the year certifies that at no time during the year was the working capital less than a certain figures?

MR. MILNER: No, the auditor could not certify

that, Mr. Brown, because he would have no knowledge of that fact. Our by-laws do require that at all times we are solvent, or solvent according to those figures. There are a number of instances in respect to the dual operation; this is more particularly true to the stock end of our business rather than the bond end, there are numerous firms which supply additional capital to cover their stock commitments over short periods of time.

COMMISSIONER BRWON; Before we finish with that point I wonder if you would also like to outline the history of the increase in these requirements as the volume of business grew in the postwar period, because it is indicative of the continuing of the association to make sure that as business grows in volume the minimum requirements are stepped up?

MR. MILNER: Well, our original minimum requirements were $10,000. That was the original minimum requirement. It was a long process of education in convincing members from coast to coast of the necessity of having sufficient capital in their operations to cover their operations. In our brief we have attempted to state that we do not want to stop anyone joining our association. We welcome as many of the smaller firms as possible. We think that it is in the best interest of the country to have them members of the association, but the requirements have moved up over that period of years as business has increased and as the necessity for having stricter marginal regulations have increased. It is quite conceivable that sometime

in the not too distant future the $25,000 might have to be raised to say $50,000.

COMMISSIONER LEMAN: Mr. Milner, these figures you have quoted starting at $10,000 some years back and now $25,000, being the minimum now, that does not mean much to me in relation to a firm say which would take on an underwriting in the millions of dollars. How is this capital related to the business?

MR. MILNER: A firm with $25,000 does not take those liabilities. The firms with $25,000 are practically entirely retail distributing firms who are not working on a commitment basis, but really operate as agents.

MR. BEATTY: This is free working capital after margining.

COMMISSIONER LEMAN: Could you describe this for us just a little bit more? Tell us how the capital must be related to the business done, especially in the underwriting field?

MR. GASSARD: Mr. Leman, this is a rather complicated thing to answer unless you have the by-law in front of you. It is in our Exhibit file, 8.A, page 405 of the blue book.

This by-law, which I said was a margining by-law, and as your inventory goes up you must margin it. For instance let us take bonds on page 408; within six months it is one-tenth of one per cent of the market value; six months to three years it is one point and so on up to twenty years when it is five points. So, if you have an inventory of a millioı dollars worth

of long-term Government of Canada bonds you must margin that at five points, or five per cent, so the firm would have to have $50,000 Government capital to margin that, and it must maintain the liquidity requirement which is set out on page 407.

"Each Member shall have and maintain at all times a minimum liquid capital in accordance with the following requirements, namely:

(a) Such liquid capital must be at least $25,000; and

(b) Such liquid capital must be at least sufficient to provide an adjusted liquid capital equal to the sum of

(i) 2 per cent of the Member's current liabilities or $50,000 whichever is the less;

(ii) 2 per cent of the Member's adjusted liabilities; and

(iii) such additional amounts, if any, as may be required by Regulation 3.

Subject to Regulation 4, the adjusted liquid capital of a Member which does not deposit all clients' free credit balance in a clients' trust account or which carries margin accounts for clients or which sells securities on an instalment payment plan ...."

All these factors govern. There you have margin accounts which are carried for clients, partners, directors and shareholders and accounts with other dealers which have not been settled within 25 days, and this applies to securities which the member has contracted to produce and the securities which the member has contracted to sell, except to the extent of those covered by purchase commitments. In other words, every factor in the investment

dealer's balance sheet has been weighed so as to speak with a potential loss factor which must be -- his capital must be able to take care of this and leave a margin of safety, so the big firm must have big capital and the small firm may have to get along with $25,000.

COMMISSIONER LEMAN: If the firm underwrites a $10 million issue and was in the syndicate type of arrangement and keeps $2 million of the underwriting for itself, say, then is that not the amount of capital you must have at the moment it indicates it is light?

MR. GASSARD: On page 409 it says that this is for ten years, and this is a very substantial margin, in my opinion.

COMMISSIONER LEMAN: Would that amount to $200,000?

MR. GASSARD: Yes. Mr. Adamson might want to add to that.

MR. MILNER: Do you want to add anything further to that?

MR. ADAMSON: No.

COMMISSIONER LEMAN: I would like to turn now to a slightly different type of question in my mind, and that is the form that opposition takes in the industry, and by relation again to the various types of things we have talked about; the integrated firms, and the distributing firms and the specialty firms. Does competition among them take a different character according to the type of business they do?

MR. MILNER: Well, Mr. Leman, I do not know

what business there is that has not got competition. Even the aluminum business has a certain amount, I fancy!

THE CHAIRMAN: So they claim!

MR. MILNER: That is a very broad general type of question that you are asking. I am going to have Mr. Hunter speak to that, who is pretty conversant with the competition in the secondary market operation, which is really where at least 50 per cent of the competition is, if not 75 per cent.

MR. HUNTER: Mr. Commissioner, I would like to say that the investment industry appears to attract men who are competitive by nature, and I do not think that they are aggressive only with regard to trying to make a profit, but I think they strive to build businesses of a lasting nature and their desire is to provide their services. Their performance is the yardstick by which their firms are engaged by the public, and this obviously requires a high degree of competition.

In our trading operations if we were not highly competitive we would not do any business; somebody else would beat us, so we must be very competitive in that area. Again, in tendering for new issues, if we try to buy those too cheaply we will not do the business; we have to be highly competitive. We try to specialize in various areas and we try to get the best personnel that we can to do that special work. We spend a lot of money on research so that we feel we are well supported, in our judgment. We spend a lot of money on our accounting and delivery practice and we spend a

lot of money on branch operations throughout the country. This all stems from the desire of the people in the businesses to develop a proper image with the public; an image of integrity and a desire to provide the best service possible. I think this is evident in the narrow spreads which exist in the bond market at most times for most actively traded issues.

COMMISSIONER LEMAN: In the field of distribution, obviously competition would be in a large part based on the sales force; its competence and the number of people they have. Strictly in the underwriting field what form does the competition take? Do you find in general that borrowers will shop around to find an underwriting that will give them the best price?

MR. MILNER: Let me ask Mr. Shaw to answer that because he is in the underwriting field.

MR. SHAW: Again, Mr. Commissioner, it is a broad question. Basically, I think one has to qualify what an underwriting department in an individual firm is. It is not a compartment of the business with firm boundaries with so many people doing that and nothing that. The underwriting section of any company is a very important function and a function that attracts the attention of the senior people, particularly if you are introducing a new underwriting into your underwriting family.

As Mr.Hunter has said, probably our most precious asset is the reputation we enjoy in the financial community, and the reputation that we enjoy with the corporations that we serve and the adjustors that we serve.

I think a responsible firm views a new addition to its underwriting family very much as a fond parent might take a look at a suitor for his daughter's hand.

A firm's reputation in the underwriting field is built up over a period of years and the firm is judged by the experience and the securities issued from its underwritings in the active market. Every firm is most anxious, if they build up a good reputation, that they avoid introducing a bad act anywhere because that can be very serious and very damaging, so although it is the desire of every house to make as many underwritings as we possibly can, we screen those underwritings with the greatest of care.

Further to the competitive elements, every firm is anxious to do as much underwriting as it possibly can of the type that fits their particular ideas and the sort of security that they want to handle, and those ideas may vary from firm to firm; some firms will concentrate entirely on an investment type of security and they will require a long record of earnings and of successful management. Not that they look askance at new ventures, but simply once they have established for themselves a reputation in the field for handling only investment securities, they do not feel that they can endanger their position by going too far afield and getting into more adventuresome fields. Some will specialize in this type of thing and do an extremely good job in most cases. The cases where there is mingling

of underwritings of investment type securities on the one hand and on a speculative or new venture type of security on the other hand are not too frequent. There is in this area quite a degree of specialization. The competition is there and it manifests itself in many ways and it is basically an established record of that firm being able to do a good distributing job and to maintain a good active market for the securities placed in their hands.

COMMISSIONER LEMAN: You said that my question was very broad; I think your answer was even broader! I specifically asked is there evidence that most borrowers do shop around for an underwriting at the lowest possible cost?

MR. SHAW: Very little evidence of that.

COMMISSIONER BROWN: There is one further point which I have; do these underwritings have a tendency to switch at all?

MR. SHAW: I missed that.

COMMISSIONER BROWN: Do the underwriting accounts have any tendency to move between houses at all?

MR. SHAW: Occasionally that does happen, but the history in the Canadian field is that the firms stay with the -- the corporations stay pretty largely with the underwriting houses with whom they have been associated for many years. We all take cracks at each others accounts, but not frequently successfully.

COMMISSIONER LEMAN: Does this reflect a bit of a lack on the part of borrowers; why do they not shop around more?

MR. SHAW: Because they are satisfied with the job that is being done for them. Perhaps it is the same reason why you do not shop around for your chartered accountants or your legal consultant.

THE CHAIRMAN: Still, in addition to that the borrower looks to the underwriter for advice.

MR. SHAW: Yes.

THE CHAIRMAN: As to when to hit the market and many other factors; as to what markets to go to, whether to go to the States or Canada in view of the changing situation, and once people become satisfied with the advice of a certain underwriter I would think they would hesitate to change and go to someone whose advice they know little about. Is not that so? That the underwriter is more than a mere underwriter, he is in a sense in an advisory capacity in most cases?

MR. SHAW: Very true, Mr. Chairman. You are reminding me of what is important, and one of the most important things is that the underwriter maintains a continuing interest in the affairs of its underwriting clients.

COMMISSIONER LEMAN: We are really discussing now the field of competition. Could one integrated firm go to a known large borrower and say, "We could do just as good a job as the fellow who has been doing it for you for the last 15 years." Is this done a great deal?

MR. SHAW: We suspect that that sort of an approach is occasionally made!

COMMISSIONER LEMAN: In Exhibit C of Section A, the first part of Section A, there is a record there of the movements in and out of the industry between 1955 and 1962. Does that reveal anything to us from this angle of competition? You saw how many members moved out of the industry during that period and how many new ones came in, and it seems that 47 have moved out of the industry and 31 new members came in, and there are reasons why they went out.

As a matter of fact, among those reasons there is one that puzzles me; it says "Reason for resignation: resigned and later rejoined". That is hardly a reason for resignation; it is more just a fact is it not?

MR. MILNER: I will ask Mr. Gassard to answer that because he deals with that.

MR. GASSARD: The history of our membership record shows that because we have so many small members, because the investment business is to a very distinct extent dependent on people, personalities, senior dealers, that you will find there is a constant succession of mergers and split-offs and changes of various kinds occurring. One of these two resignations resulted from a western firm becoming affiliated with an eastern house and it was decided that the western firm would resign from the Association. A few months later they decided there were certain interests they wanted to carry on in a separate business, and they reformed the business and applied for membership again. You might

say that these are just for reasons of business strategy; they found that they could conduct a certain type of business, perhaps a short bond business and at first they thought they would not need the membership, and then they decided that they would like to start over again.

COMMISSIONER LEMAN: I notice from this exhibit that for quite a number of cases of going out of business it was a personality problem, the senior partner or the owner of the firm died, or something, but are there cases -- is there evidence of competition here from firms that resigned or went out of the business because it was too tough, the competition was too difficult to meet?

MR. MILNER: Well, I think as far as I can recollect I do not think we have ever had a person go out of business because he was forced out of business. Some of them have gone out of business, particularly in the smaller firms where you had one or two partners only, a very small firm, and just using a hypothetical example, where the father, one of the partners, wanted the boy to go into his own business, so he goes into a totally different business and the other one cannot carry on and joins another firm.

Conversely to that, every year or nearly every year we see splinter firms being formed from the larger underwriting houses; people leaving the large underwriting houses feeling that they will have a greater opportunity on their own than staying with the large underwriting house or with the large national house

[illegible]

and it varies up and down. There have been a number of mergers and there have been a few resignations for reasons that I stated before, where the business simply ceased to exist, but by and large I think we have had surprisingly few people literally go out of the business.

COMMISSIONER LEMAN: Does that throw any light on the competitive atmosphere in the industry?

MR.MILNER: I would not think so, no.

COMMISSIONER LEMAN: Well, there is a reference in the brief to the effect that what you call the retail business is very difficult to carry on. I think it is paragraph 22 in Section A. It says at the end of that paragraph:

> "Costs of doing business rose steadily during the 1950's and it has become more difficult to carry on a retail business at a profit."

MR. MILNER: I will ask Mr. Kinnear to speak on that; that was in his brief and it is on the retailing of securities from the viewpoint of our industry.

MR. KINNEAR: I think the reason for that is that the cost of doing business on a retail basis, based on the spreads which are available in competitive selling to the secondary market are so small for an investment dealer to send ~~a~~ salesman out into the rural parts and pay all his expenses, and unless he does a terrific volume it is done more or less at a loss to the firm.

Many firms do have a large rural sales force and depend a good deal on the total volume which is done

rather than the individual profits per sale.

One of the ways many firms get around this is by having men living in so-called rural spots where their cost of doing business is cut down from living, say, in a major spot and going out every week to sell securities and to call on their clients. It is essential in the retail end of our business to make personal calls and many clients like to be called on personally.

Now, this is particularly true in certain areas such as the rural parts of Quebec, where clients like to be offered the securities of various municipalities, and so on, and unless you call on them personally it just would not get that business, but I think that by maintaining the broad coverage on clients right across the country, even though part of it is done at a loss, the 98 members are assisting in a widespread ownership of fixed obligations and equities in Canada.

Does that answer your question?

COMMISSIONER LEMAN: Yes, except that I would like to relate this to the figures you have given us. In Exhibits A and B of your brief there are some figures about the sales force employed in the industry in Canada, and it shows the personnel data -- Exhibit A, page 26 -- and it seems as though the sales staff in the industry has increased somewhat?

MR. KINNEAR: That is correct.

COMMISSIONER LEMAN: In recent years. Have these been mostly concentrated in the big firms that tend to get bigger?

MR. KINNEAR: No, I would say in the first place many firms are looking to the future. They are taking on younger men, training them for managerial and executive positions in the future. One of the training periods for those men is to have some practical experience; that is one reason. Another reason is that many firms -- some of the smaller ones -- have gone extensively into mutual funds and have built their sales force so they can get as broad a coverage as possible. I would think it is the normal growth in the sales force.

MR. MILNER: As an example, in the Province of Quebec four years ago there were something like 500 registered salesmen within the securities commission in Quebec practically all of whom belonged to the Investment Dealers' Association, in the main -- 80 per cent of them did. In the last four years that has gone up by about 10 per cent only in new entries into our business, but in the meantime there are now 3,000

registered salesmen in the Province of Quebec, so the other 2,400 are practically all mutual fund salesmen. A number of our houses have gone in for the distributing of mutual funds as an added adjunct to their business. As Mr. Kinnear said, it enables them to keep people in the smaller areas because the profit on the sale of mutual funds compensates them for selling other securities at the same time. There are differences all across the country in the formation in our own industry.

I think you would interested in having Mr. Johnson speak to you for a minute on the retail distribution which exists in Quebec, which is the only province it exists in on municipal securities.

MR. JOHNSON: In the Province of Quebec, historically the small investors have always been interested in fixed interest obligations starting originally in the form of mortgages usually handled by the local notary, and in more recent years as our industry has expanded they have gone into the purchase of bonds, usually bonds of local interest, and firms such as mine have found that it was good business to establish salesmen throughout the rural areas that were permanently located, not working out of a branch. We found this has been helpful to the local economy in the province because it has created a demand for securities of smaller municipalities and school boards that would have been difficult to sell to institutions or to more sophisticated investors: They like the larger situations where they get a broader annual

report from the secretary-treasurer.

I think that about covers it.

COMMISSIONER LEMAN: What I would like to understand, though, is your reference to the fact that it is costing more and more to handle the retail business. Do you mean literally that the retail business had become less and less profitable in the absolute?

MR. KINNEAR: In certain phases. If you are distributing Government of Canada bonds in the rural parts of the country and maintain the same spread you would get in Montreal, Toronto or Winnipeg, it is only natural you can't make very much money because you have your salesmen's travelling expenses, delivery costs and so on. That part of the business is becoming less profitable to investment firms if the prices are competitive, which they are. However, a retail business from coast to coast is essential because you can't do underwritings for new ventures, new companies, and expect to sell them all to the sophisticated investor, and by having a retail organization you can seek out the spots where people would like to invest in a company of that nature.

I can give you dozesn of examples of underwritings which have been done for various firms where you could not sell part of a fixed obligation to any institutions. You had to seek buyers for it. The institution would come along later, after the company had been more or less seasoned, but not in the initial stage. Therefore, I think it is important that a retail organization be kept healthy for that reason.

THE CHAIRMAN: Does the retail organization, for instance in your firm, devote itself to certain areas in, say, the Province of Quebec, and some other firms might service other areas, or is there an overlapping?

MR. KINNEAR: There is competition right through.

THE CHAIRMAN: Competition from home to home?

MR. KINNEAR: That is correct. I have never heard of firms dividing up the country. It is the opposite.

COMMISSIONER LEMAN: On the other hand, in A.32 you show the broad distribution of the number of firms that operate across Canada and those that do not. It does seem like a very few firms seem to be able to afford a real blanketing branch system. I am referring to page 10, "Area Served": 144 firms operate only in one province, and 25 in two provinces, and then you come down to very small figures. How do those firms which operate only in one province, which are by far the largest majority -- they operate only in the big provinces like Ontario and Quebec, or all provinces?

MR. KINNEAR: All provinces, but I think there are more in the more populous provinces of Quebec and Ontario. There are smaller firms in all provinces -- a great number in British Columbia -- in all the provinces of Canada, and they do largely a retail business in the territory in which they serve. Most of those firms are not underwriters except in a limited sense but they co-operate with the larger firms in distributing underwritings of the larger firms.

COMMISSIONER LEMAN: To an underwiting firm good

distribution is also very important. Would you suggest that retailing is so little profitable that the big integrated firms make up for that through the underwriting? Is it the underwriting part that provides most of the profit?

MR. KINNEAR: Underwriting is an important factor in the profits of the larger firms, but they would not be able to do many of the underwritings unless they themselves had a large retail organization, and possibly we should look at the over-all picture rather than the profit made on one or two or five bonds in a rural area, because if you analyzed that particular sale possibly you come up with a loss.

COMMISSIONER MacKEEN: In other words, say you take on an underwriting where you were reasonably sure of selling 80 per cent to institutions, and found difficulty in getting rid of the last 20 per cent: If you have a retail organization behind you, you are pretty sure over a period you can dispose of the whole 100 per cent?

MR. KINNEAR: That is correct.

MR. GASSARD: May I add also, I have been told by a number of our senior dealers that clienteles have the habit of moving away or dying or changing to the competitor, and unless you are out every week building new names on your list you are not going to be in business too long. The late Mr. Ralph Baker, the General Manager of James Richardson, said they had many accounts on which they lost money, but they did it on the theory that enough of these accounts

properly handled would become large enough to become profitable accounts. In other words, they form a sort of a nursery which will grow, which is exactly what many of our dealers did with corporate accounts.

MR.MILNER: I will go one step further, Mr. Leman, to say -- and this is my own personal view -- but I would be sure that in Canada we could not have 50 national houses; there would be too many national houses for the amount of business available. If we have got roughly between 8 and 10 of our members that you would call national houses -- and by "national houses" we refer to people who go from coast to coast; then there is a second group that have, say, five branches only: Some may not be in British Columbia, or not in Winnipeg, or may not be in Halifax. There are 25 members who are in two provinces, but there are a number of large firms -- after all, the only way that money can be made in our industry in the underwriting of corporate securities, if you want to confine it to that end, is in selling the last million. If there is an issue of 15 million the money is all made in the selling of the last million. If you are left with one million you cannot sell, you have had a very unprofitable transaction. Therefore, the large underwriting houses have by necessity been forced to, even though it may not be on a bookkeeping basis -- all their branches might not literally make money, but they do make money in the long run because having those branches enables them to dispose of that hypothetical last 10 per cent.

COMMISSIONER LEMAN: But that is a case where it is the underwriting that pays the firm, and they have to have a distribution force to put it out into the public?

MR. MILNER: The national houses have to have underwritings. They could not exist without underwritings, but they need the co-operation of all these smaller houses in their selling groups and banking groups -- I am speaking of industrials now -- and if you go on to the provincial financing the same situation exists there, that when the Province of Quebec or the Province of Ontario issue $50 million worth of securities, there again the successful issue is the one where the whole 50 is sold and not only 45.

COMMISSIONER LEMAN: Is it possible to state in quantitative terms what volume it takes to keep a salesman on the road? An insurance company could tell us how much a salesman has to sell in a year in order to make a living and earn something for his employer. Is it possible to measure that in your type of business?

MR. MILNER: Let me ask Mr. Ely of Wood Gundy.

MR. ELY: It is not an easy question, Mr. Leman, but I would guess that a salesman, if the particular salesman were earning $10,000 a year he should produce four times that much for his firm, because behind that salesman there would be four to six people: Delivery department, accounting department, research department, trading department -- all the departments that work behind the salesman and service

him with prices and telephone calls and, from the accounting standpoint, service him by paying his travelling expenses. My off-the-cuff guess would be he would have to produce four times as much as he makes for his firm for the firm as a whole to break even; that is minimum. In most cases those salesmen are guaranteed a certain minimum, and if they don't stand up to that guarantee over a period of years, a change takes place.

COMMISSIONER MACKINTOSH: How much would he have to sell in order to produce the 50 thousand?

MR. ELY: That depends entirely upon the type of security he is selling and the profit margin in the security. Let us look at provincial,government and provincial securities: It is a published fact that the underwriting firm, the distributing firm, makes X spread and if he were selling, let us say, Dominion of Canada bonds -- I only refer now to new issues because outstanding issues are traded on a very narrow margin -- as far as new issues are concerned, depending on maturity the spread is, let us say, on average in the longer maturities three-quarters of one per cent, and that is as much as it ever is except on savings loan bonds. That is $7.50 a thousand, so that fellow has got to sell -- if he sells $1 million worth, his firm makes $7,500. So, for him to make $10,000 he has got to sell in the nature of $7 million or $8 million worth of those things in a year with all the attendant expense of doing a retail business.

COMMISSIONER LEMAN: This matter of spreads:

Does the association have anything to do with the establishment of spreads, say, for underwriting, selling, distributing? Is that all set down, or does each firm when it handles a new issue set that for itself and for the group with which it works?

MR. ELY: As far as corporate underwritings are concerned, the particular firm that does the underwriting sets the spread in conjunction with the borrower.

COMMISSIONER MACKINTOSH: It is part of the agreement?

MR. ELY: It is part of the agreement between the borrower and the dealer, and by mutual negotiation they arrive at what seems to be a proper spread for raising that kind of money. That is in the corporate area. Once you move into the Dominion of Canada, provincials, the spread is set by the borrower. If a Dominion of Canada issue is announced, it is announced to the trade what the spread will be.

In provincial securities some are done by negotiation, some are done by public auction and the winner at public auction decides then what spread he can take over and above his cost commensurate with market conditions. In provincials the spread on a negotiated piece of business is agreed upon and the price to the buyers agreed upon.

COMMISSIONER LEMAN: Yes, I understand that. Between the borrower and the public there is a total spread negotiated in the private sector and not negotiated in the public sector but as between the various buyers that are needed in order to get these securities into the hands of the public are there association rules as to how much the selling group will get as compared with the banking group etc., or is that really a matter of private negotiation?

MR. ELY: It is really a matter of private negotiation and usage over the years. Let us put it this way: On a provincial issue that has been negotiated to make it simple the gross spread is one per cent. Usually in those negotiated issues the syndicate that negotiates them under the leadership of one manager take a part of that one per cent for taking the complete liability before they start to sell it. In practice that might be one-quarter of one per cent. The remaining three-quarters is paid to the distributing house for placing those securities with the private investor or the institutional investor and out of that three-quarters of one per cent a further commission can be allowed under certain circumstances to sub-agents,

casual dealers that are not in the group and trust companies in certain instances where trust companies are allowed under law to take it. Does that answer your question, sir?

COMMISSIONER LEMAN: Well, is it fairly fixed or does it vary a lot?

MR. ELY: The Association have absolutely nothing to do with controlling that. It is none of their business. They are an association. That is up to the individual dealer or group of dealers who negotiate their deal. The competition is so keen that you just simply cannot overrun a proper normal rule-of-thumb. You just do not make a large commission. If you do you are damaging something; you are either not being fair to the borrower or you are not being fair to the fellow who buys so that this keep your spread down.

COMMISSIONER LEMAN: There again I was not thinking of the borrower or the investor; I was thinking of the distribution of the cost as between firms that distribute, firms that sell and firms that underwrite etc., and I am talking about the related amount of spread that they get as between the type of firm and the job they do. That is pretty well fixed too -- how much they get for selling, how much there is for underwriting etc., or does it vary a great deal?

MR. ELY: In the case of the large integrated houses they do everything so whatever their percentage interest is in a particular piece of business involved they get the original profit for taking the liability

and then they get that portion of the remainder which is their portion in the particular syndicate for distributing.

COMMISSIONER LEMAN: There that is the firm that does the whole thing?

MR. ELY: That is right.

COMMISSIONER LEMAN: But the firm that does not do the whole operation, it gets the same proportion of the total for just selling, doesn't it?

MR. ELY: For just selling. The firm that takes no liability and does not underwrite and just sells gets a proportion of the gross and that proportion, while it is not standard, it is pretty well standard. I would guess that the selling firm by and large, if he is in the banking group, probably gets 75 per cent of it. If he is in a selling group he probably gets 50 per cent of it.

COMMISSIONER LEMAN: So these are about the usual proportions -- about 50 per cent is for selling?

MR. ELY: About 50 per cent for selling. A 100 per cent for taking a liability and something in between that for the group at large that may not be applied actually in selling.

COMMISSIONER LEMAN: Would that also vary with the type of security that is being distributed?

MR. ELY: That would vary.

COMMISSIONER LEMAN: In other words there might be securities where the underwriting risk is much less than in the case of others and the selling costs much more?

MR. ELY; I do not think the percentages would vary too much but the gross spread might vary according to the type of security you are selling. Just as it is now on Dominion of Canada bonds and not quite as narrow on provincial bonds it gets wider on other types of securities which take a greater effort to sell. I think the same percentages apply.

MR. MILNER: It would be very close to the figures Mr. Ely gave that you could say that the house that is distributing with no liability where he was, to use an example, on a provincial bond, he gets one-half of one per cent for selling it. If it was a corporate bond with two points between the spread he would get one per cent for selling it and if it was a preferred stock with three points he would get one and a half for selling.

COMMISSIONER LEMAN: Which is still about half.

MR. MILNER: About half the total.

COMMISSIONER LEMAN: In your annual meetings of the Investment Dealers' Association there has never been any discussion of these relative remunerations for the various functions, there has never been any effort or suggestion made that that might be a matter for the association to deal with?

MR. MILNER: Well, Mr. Leman, our Association primarily was formed to do all the things that could be better done as a group rather than individual firms having to do the same type of thing over again. But the Association has never attempted to legislate anything

in the way of spreads between firms or underwriting profits or they have never made any effort as an Association to go into whether bank groups are properly formed; in other words, whether there should be a different allocation of banking groups or whether there should be a different allocation of selling groups. Those matters are between the large underwriting syndicates or the underwriting houses and the dealers that join them in their particular issues. The Association does nothing in the way of that type of regulation except the one thing that we do not permit what we call unconscionable profit. If an underwriting firm tried to take 25 per cent profit on selling something to the public we would take a violent objection. We say that is unfair.

MR. GASSARD: In fact, our constitution since the founding of the Association strictly forbids the Association to become involved in the discussion of prices or arrangements or anything tending to restrict competition of trade.

COMMISSIONER LEMAN: Would that be a restraint on trade type of thing?

MR. GASSARD: It might be so considered, the founding fathers thought.

MR. MILNER: I can assure you there is no price fixing in our business.

COMMISSIONER BROWN: Could I just re-open one small subject and that is, Mr. Ely suggested that the average salesman's remuneration was approximately 25 per cent of the gross. Is this general in the

industry? You suggested to make $10, 000 a firm had to make $40,000.

MR. ELY; It is usual, I believe, amongst most stock exchange houses some of which are members of our association that they would pay their salesmen one-third of the recognized stock exchange commission.

COMMISSIONER BROWN: I think that is fixed by the stock exchange, isn't it?

MR. ELY: Yes.

MR. MILNER: That is the maximum.

MR. ELY: As far as fixing the spread of a salesman you are talking about a 25 per cent multiple that I was using?

COMMISSIONER BROWN: You used 25 per cent and I merely asked if this was general in the industry.

MR. ELY: I do not know that it is general; in point of fact my firm pays considerably less.

MR. SHAW: I think what should be clarified is that there are two methods of remunerating salesmen. One is salary or guaranteed return and on top of that is the commission. If you are talking in terms of the total remuneration received by a salesman you are not far from being correct. When you use the figure of 25 per cent I think if a salesman made $10,000 the firm must make $40,000 so it is something like 20 per cent. That 20 per cent then looks after everything that we pay out to salesmen in the way of take-home pay, whether salary and commission or just commission. If he is on a straight commission this 33-1/3 per cent usage in the stock exchange usually applies when there is virtually

no other remuneration going to the salesman. He may have a drawing account against his one-third of the stock exchange commission but as far as the stock exchange is concerned that one-third represents the full pay-out.

MR. MILNER: It even goes farther than that. Now, just taking it one step farther as far as firms are concerned this is just a matter for each individual firm to make up its own mind, as to how it wants to conduct its business but some of the very large firms pay comparatively high salaries to their sales force and a very low rate of bonus or remuneration above their fixed salaries. The smaller firms, not wanting the liability of the very heavy salary pay-out, if business were not as successful as they hoped it would be have a lower salary scale and a higher commission scale. Some firms even go down to where they have a number of their sales force on no salary. Just as Mr. Shaw pointed out they work completely on commission. They are straight commission salesman. So that our industry figures, with those three factors coming in, make it very difficult to get the industry figure together.

The only way you can really assess it, I think, as far as I am concerned, Mr. Shaw and Mr. Ely have expressed it pretty accurately. If you take those three into consideration, that is, about remuneration, the end pay that goes to the salesman whether he gets it by way of a high commission and a low salary or a low salary and a high commission is about the same.

COMMISSIONER BROWN: About 20 per cent?

MR. MILNER: 20 to 25 per cent would go to the salesman.

COMMISSIONER BROWN: Could you give us the ranges?

MR. MILNER: How do you mean?

COMMISSIONER BROWN: You have indicated some people pay out on a different basis. Would the range run from 15 to 50 per cent, some firms putting out 50 per cent to salesmen?

MR. MILNER: I think some of our firms at times have paid out 60 to 65 per cent to salesmen. They have not found it worked out very well. It is too high a percentage of the overhead.

COMMISSIONER BROWN: I am asking what the range would be.

MR. MILNER: The range would be, I would say, between 10 per cent and 50 per cent.

MR. ELY: About 90 per cent would be between 20 and 25 per cent. The higher the percentage that is paid out the less likelihood there is of good backing service from salesmen.

COMMISSIONER LEMAN: I am a little surprised, though, to hear that there would be a matter of restraint of trade if the industry as such did specify what were the proper remunerations for various functions performed by that industry. If you did anything that would affect the borrower or the investor, then perhaps you could be in trouble with the law but it seems strange you would be in any trouble with the law if,

within the industry, you set out certain relative remunerations for the functions performed. I may be wrong.

MR. GASSARD: May I just say that the association has on many occasions sponsored open discussions both at our annual meetings and special meetings where various things have been brought up as to how salesmen, for instance, should be remunerated. We act as a forum, not as an adjudicator.

COMMISSIONER LEMAN: I certainly do not want to argue about it. I am just looking for facts as to how the industry works. I am not going to argue about it.

In your own statistics it looks, on page 26 or part 1 of A that it takes on the average three people to back up a salesman. It ranges from 28 per cent sales personnel down to 24 per cent sales personnel for the total, with larger firms 23 per cent. It seems normal the larger firms would have more to back up those salesmen. I suppose that is part of the research staff?

MR. ELY: Right.

COMMISSIONER LEMAN: Well, in this general section there is just one more question I would like to ask you which is as to the matter of admitting new members into the association. I think Mr. Milner, you mentioned earlier that in order to give everyone a chance to start in the business etc., the capital requirement, subject to any regulation, has not been set too high as a minimum because presumably it was felt

it was not necessary to set it too high but how are the admission procedures arranged? Can a firm say: "If I meet these standards I qualify and I will be admitted"? Can anyone join if he wants to by meeting certain very definite standards?

MR. MILNER: Well, Mr. Leman, I think I would answer that in a backward way, if I may. What we are trying to do is to upgrade our industry in every possible way we can upgrade it and it is a purely selfish motive, if you want to take it down to the finaly analysis, because every time one of our members does something that contravenes normal business ethics -- I am not speaking about criminal offences but business ethics -- the publicity going into the press affects the whole industry. Therefore, we want to be sure that new members coming in appreciate the code of ethics that we feel are necessary to belong to our association and I am going to ask Mr. Gassard to give you the regulations regarding new members but if you bear in mind that the principle is to try to be sure that the members will make good members of our association -- and we go one step farther, we now have a spot audit system that will operate that 10 per cent of our members every year have to break down their sales into categories. We want to be sure that we do not get members who are dealing in nothing but very highly speculative stocks. We do not think they should be members of our association in those circumstances. I think Mr. Gassard can give you very briefly the qualifications.

MR. GASSARD: Mr. Chairman, most enquiries about membership reach either our Toronto or Montreal offices or perhaps are addressed to the chairmen of the districts and if it comes to our office we explain the philosophy of the association, something of its standards and requirements and try to point out that membership in the association is a responsibility rather than a privilege.

If they are in earnest about this we ask them to read the by-laws and give them an application form to study which is quite a lengthy document, some six pages, which searches into the anticedents of the qualifications and experience of the firm or partnership which proposes to apply.

If they proceed on that basis, the application form is studied by the district committee concerned which looks at the references which the applicant gave -- five references within the Association -- and decides really on two bases aside from capital, and that is character and integrity of the people who are applying which are determined by a form of inquiry, and from experience and ability to conduct an investment type securities business. We have in this last year tried to define our standards more objectively by requiring that the firm agree to conduct an investment type business, but we recognize that in a young growing country like Canada with many resources to be developed, firms must also service the whole portfolio and must be prepared to do some business and accept some orders in perhaps more speculative securities. So, we require that at least 50 per cent of their business and earnings be investment type securities as defined. We define investment securities as all fixed income securities not in default of interest; preferred shares not in arrears of dividends and, common shares, whether or not dividend paying, of demonstrated earning power, and where there is any question as to whether a stock falls in that category the matter comes before

the committee and it is settled in a democratic fashion around the committee table. It is not too difficult to get a picture of the member's business.

If the committee approves the application the applicant is instructed to send his audited balance sheet to the district auditor who in due course reports upon the member's financial position, and when he signs an application form he undertakes by making a statutory declaration that he has read the by-laws and regulations and will undertake to adhere to them.

If this is a new member, every six months for three years he is required to report in some way to the committee so they can follow the type of business that the member is carrying on.

In addition to that the national executive at its audit meeting each year elects approximately 20 members by lots for an informal check to see if they are adhering to our minimum standards.

MR. MILNER: Is that sufficient for your purpose, Mr. Leman?

COMMISSIONER LEMAN: I would like to know just a little bit more. Are there statistics in regard to the number of applicants? You give us at page 29, Exhibit C, the fact that there were 31 new members admitted in the Association from 1955 to 1962. Do you have any figures as to how many people applied as compared with the number that were admitted?

MR. MILNER: Mr. Gassard, have you any figures on that?

MR. GASSARD: No.

MR. MILNER: Do you know roughly?

MR. GASSARD: I would say there is a trickle of inquiries. To give you a comparable example, we had a caller recently. He was an employee of a member firm. He apparently told his employer that he wanted to enter business for himself. He has only been in the business for four years during which time he has apparently demonstrated an aptitude for the business and has built up a substantial clientele of his own. Being an enterprising fellow probably he feels he could do better paddling his own canoe. We pointed out to him that under our by-laws he must have five years experience. I think the by-law says that the majority of the directors or the majority of the officers must have been in the business for a minimum of five years. That is to get the basic experience which in a difficult and complex industry can best be learned by trial and error.

COMMISSIONER BROWN: Would it be fair to say that rather than having applicants turned down they are disuaded from putting in an application if it looks as though they might be turned down?

MR. GASSARD: We give them the facts and point out that really membership in the Association places quite a heavy burden of responsibility on them. If they are the type we want they seem to come back and press their case. If they are the wrong type from the standpoint of our regulations, that is the last we hear of them.

MR. ELY: I think it would be fair to say that if we accepted 31 members in a year we would not have

had more than 35 applications.

MR. MILNER: That was not in one year.

MR. SHAW: At the application stage there would be very few turned down. If they are suitable applicants, and that is established before you get to the application stage, there would be very few turned down. It would not be in the applicant's interest to be turned down, and in most cases it works out that the applicant decides to take the advice from the officers as to what he must do to better qualify himself before getting to the application stage. In my experience I can think of very, very few cases of an application that has been actually filed and not favourably dealt with.

MR. MILNER: Of course, in addition to that, the applicant has to have five sponsors, and there is where the difficulty comes to a person who is of dubious quality. He cannot find five members who will sponsor him so his application never gets as far as the Association.

COMMISSIONER LEMAN: Oh, one needs to be sponsored?

MR. GASSARD: May I correct that? The word is "references".

MR. MILNER: Yes, references, but there are cases where the references will come up and say that they do not think that the applicant is the type of person qualified and it ends there. There are a number of firms which might have started had they had proper qualifications to start with, but they found out in time and never made an application form.

COMMISSIONER LEMAN: I see. Perhaps we might break if you wish, Mr. Chairman.

THE CHAIRMAN: Have you more questions on this point?

COMMISSIONER LEMAN: Well, I was going to change the subject a little bit.

THE CHAIRMAN: We will adjourn for about ten minutes.

(At this point a short recess was taken.)

THE CHAIRMAN: We will now resume.

COMMISSIONER MACKINTOSH: Mr. Chairman, I have one or two questions I should like to ask relating to Mr. Leman's questions. We were talking about the entrance into the industry and differences between the various houses. Are the big houses in the industry getting bigger and the smaller houses getting fewer, or what is the growth trend of the industry?

MR. MILNER: The growth trend, Mr. Mackintosh, and this is a pretty broad statement, indicates that the large houses have not got appreciably bigger in the last five years. Secondary portion of the houses have grown. If you take the eight or ten which you might call national houses and take the remaining 24 in that secondary group, that group has grown. In the bottom bracket, the smaller bracket, the personnel has grown but largely for the reason that we were mentioning here before. There is a lot of mutual fund activity among that 120 or 130 remaining members. If you include our stock houses you would have even a greater proportion.

Our figure did not include the stock houses because they are reporting directly to the stock exchange.

COMMISSIONER MACKINTOSH: Among the smaller group is there much amalgamation going on? Are these smaller houses getting together to make somewhat bigger houses?

MR. MILNER: No, the tendency has been more for the smaller houses, or the minimum sized houses to merge with larger houses; witness, for instance, Dawson -- Haniford with Greenshields. There has been that type of amalgamation. There has not been very much of the small houses amalgamating between themselves. I think I am right in that, Mr. Gassard, am I?

MR. GASSARD: I am not as sure of that as I was a year ago. I thought that the trend was going to continue, but it sort of came to a stop and I do not know now where we are.

MR. BEATTY: We have had one amalgamation and one split-up in the last six months.

MR. GASSARD: We do not have the statistics. For instance, these figures we gave in Section A are not sufficient to indicate that trend. One would have to have a longer series than we were able to provide to state anything definite about this trend.

COMMISSIONER MACKINTOSH: For another purpose you give some other figures in Section F on page 8, figures on inventories. They are not very useful for this purpose in that you include far too many houses in each group. You have 33 there and not the number which Mr.Milner spoke and the figures are only for one year. They are just for different dates in the one year. The same figures broken down a bit more would perhaps give a better idea what the distribution was.

MR. MILNER: Dr. Mackintosh, let me answer that this way. In providing those figures for the one year it was a fantastically difficult job for the industry on account of the fact that practically no two firms have the same accounting practices or the same way of keeping their own records. Some firms want theirs kept by salesmen and some by securities, and to go back and take them out individually would be a very difficult task, and when it came to going back over two or three years before that we found it impossible to get them, and particularly for the firms that are on IBM; anything on mechanical bookkeeping where you just have a card with a number on it and you have to take each individual card and you have to go back to get it to match the security and it becomes an impossible task to do for any further than the one year.

COMMISSINER MACKINTOSH: I don't know that inventory is the best measure of size and extent of activities in any case; I merely referred to that as it

was one table in which this distinction between larger and smaller houses was made. Perhaps you can suggest a more available and suitable measure?

MR. MILNER: We can submit to you a breakdown breaking that down further from 33 to 8 and 8 and 25; if you would care to have that we can have those figures submitted.

COMMISSIONER MACKINTOSH: I would think that would be useful; we would be very grateful.

MR. MILNER: Do you have those figures there, Mr. Adamson?

MR. ADAMSON: Yes.

MR. MILNER: Would you want them right away, Dr. Mackintosh?

COMMISSIONER MACKINTOSH: No.

MR. MILNER: We can give you them tonight.

COMMISSIONER LEMAN: In the personnel series, which you give us at pages 26 and 28 in A.1, you look at staff and you find that in 1958 -- if we look at the over 100 section -- it was 4400 out of 8600 total personnel, which is about 50 per cent. If we look at 1961 and look at 100 and over, we find we get 56, a little over 5600 out of 9300, which is 61 per cent.

MR. MILNER: That is what I was saying before, that your middle house, your group just under the national house, has increased and the other ones haven't gone down. There has been a big change in the number of personnel in the 24 houses under the top eight or 9 houses. Your percentage goes up to about 60 odd per cent from 50 per cent back three or four years ago.

COMMISSIONER LEMAN: This, of course, doesn't cover the whole industry, does it?

MR. MILNER: It covers the membership.

COMMISSIONER LEMAN: You see, in one case you have 100 and over and in the next case you break it down to ones under 200 and then over 200 and I imagine that you add the two together to get a percentage for 100 and over. How many firms does that represent out of a total membership of 100 and over?

MR. MILNER: 18 firms.

COMMISSIONER LEMAN: 18 out of 191?

MR. MILNER: Your total is 196 firms and that includes all the stock houses in these firms because they were having to do with working capital or profits or anything else, so this is all our members, these tables, and I think you will find when you get the stock exchange brief from the stock exchange people you will see that it will tie into these figures. I am not sure, but I can find out as to how much increase there was in what we call stock houses or stock members, purely stock members.

MR. GASSARD: Mr. Milner's point is borne out by the fact that our 1958 survey showed 18 firms with 100 and over staff and the 1961 figures showed 24 firms in that group, so those firms crossed that boundary line.

COMMISSIONER LEMAN: This brings me to a point which you make in part 2 of that same section, more specifically paragraph 46 where you register in a sense a complaint about the lack of the available statistics

in certain areas of the industry. You indicate some of the difficulties you have about getting adequate statistics and you say, "fiscal-year-ends among our Members fall throughout the calendar year; some firms record sales ...", and you list the particulars. Isn't this an area where the association could do something?

MR. MILNER: I will ask Mr. Beatty to speak to that; he is present and is now taking this task on.

MR. BEATTY: Mr. Leman, we were very impressed with the value to the association of the preparation of the statistics for this Commission, and at our annual meeting the national executive discussed the continuation of the preparation of such statistics on an annual basis for the use of our membership and decided in favour of it. We also will endeavour to persuade our members as far as possible to standardize the procedures in order to make these statistics more consistent and accurate.

Also, at the same time as our preparation for the brief has been taking place, we have entered into efforts with the Dominion Bureau of Statistics to furnish important statistics regarding the capital flow through our industry for them and I believe that this will help our own series as well.

Also, we have made available to the Bank of Canada and the Department of Finance and the Dominion Bureau of Statistics our own series which we prepare weekly on the capital flow through the system.

We don't feel, however, that these particular statistics are sufficiently well developed to merit their publication, but we are working on them.

COMMISSIONER LEMAN: This is what you are referring to in paragraph 56 where you say that this is your intention. Could you specifically say what series, what statistical series you have in mind starting in and maintaining in the future, or is that not quite set yet?

MR. BEATTY: It is not quite set yet, other than the fact that the statistical data prepared for the Commission appeared to us to have considerable value and we wish to maintain this on an annual basis. It is much simpler for us to plan in the future the development of statistics than to dig them out in the past. If we know we are going to require them it will be easy for us to keep them up. This relates to capital, profits, the whole series; inventory.

COMMISSIONER LEMAN: If we might turn to another subject now, I would like to talk a little bit about underwriting. You describe in the brief what the procedure is for underwriting. Starting first with paragraph A.51 -- it is A.56, rather -- I would like to get a somewhat clearer explanation of exactly what are the normal steps for an underwriting, and this is in the area of corporate underwriting.

MR. MILNER: Yes.

COMMISSIONER LEMAN: The implication from what I read here is that an underwriting agreement is signed, after which a prospectus and various other

documents are prepared. Does that give the impression that the price that the borrower is going to get is fixed before these other steps are taken; is that the proper conclusion?

MR. MILNER: Are you referring now to corporate underwriting or referring to underwriting generally, because there are two sections to it.

COMMISSIONER LEMAN: Let us start with corporate underwriting.

MR. MILNER: It is Appendix E, that is the one which we want on corporate underwriting.

COMMISSIONER LEMAN: Yes, there is a description of it in this series in the paragraphs on page 18, 19 and 20 of that section.

MR. MILNER: I am going to ask Mr. Sutton to speak to that corporate underwriting.

MR. SUTTON: Mr. Leman, your question relates to the timing and pricing of an issue, is that right?

COMMISSIONER LEMAN: Yes, when the prices are actually fixed. Usually in the discussions between the underwriter and the borrower some indication is given of the area of the price which probably would be utilized -- and which remains in the area -- but the specific price is not established until quite shortly before the issue is filed with the Securities Commission. This is because market conditions can change, of course.

COMMISSIONER LEMAN: And that is quite shortly before the issue, a week, or what?

MR. SUTTON: No, sometimes it is even a few days, sometimes one day.

MR. MILNER: In a nervous market a person is left until the last moment that is possible before coming out with the issue, and the borrower is fully aware, as Mr.Sutton says, that there is a spread -- he has agreed, for instance, that his money cost will be somewhere, let us say, between $5\frac{1}{2}$ and $5\frac{3}{4}$ per cent; between a range that would be given at the initial discussions.

If during the interval between the discussions and the coming to market, the market changed so it had to go to 6 per cent, the underwriter would have to go back to the corporation and say, "It is impossible to do under the spread we have got now, between $5\frac{1}{2}$ and $5\frac{3}{4}$; do you want to go ahead at 6%?" and the answer would be either yes or no, we will go ahead regardless of that. From the underwriters' viewpoint the profit margin remains the same. There is no additional profit no matter where the pricing is. Let us assume there was $2\frac{1}{2}$ points in the business, $2\frac{1}{2}$ per cent, it would be the same $2\frac{1}{2}$ per cent whether there was $5\frac{1}{2}$ selling at 99 or 98, it just comes off the bottom end.

COMMISSIONER LEMAN: Provided you sold to both of them?

MR. MILNER: Yes, the margin is not increased in the normal -- the arrangement is made with the -- or, the borrower makes the arrangement with the underwriter initially as to what is the proper amount or margin -- or whatever you want to call it -- to issue to the public.

COMMISSIONER MACKINTOSH: But if you are moving at the 6 per cent and the issue is over-subscribed and all sold by 10 o'clock in the morning, that is a more profitable operation than if you had priced it very closely and it takes some weeks to clear it all up?

MR. MILNER: Yes, that is correct, but the underwriter is taking his best judgment as to the proper price of an issue. An issue that is properly priced, the hope is it will go to a slight premium. The underwriter does not want to see an issue go to a 5 per cent or 6 per cent premium. It just kills the whole distribution. You have got the wrong people owning the issue, and you have the great problem of having to resell it in the secondary market.

COMMISSIONER MACKINTOSH: I was not criticizing the procedure. I was just trying to understand.

COMMISSIONER LEMAN: In this process of judging the market, what are the tools at the disposal of the underwriter or the manager of the syndicate? There is his judgment, with prevailing prices of bonds of the same quality in the market at the time, but can he do anything more to help his judgment?

MR. MILNER: I wish there were, but we live largely by our wits as far as pricing an issue is concerned. We have to try to assess the prevailing market on securities both as to whether we are in a rising market or a falling market, and we have to judge the availability in the market at the time of issue of similar securities of an equal calibre and try to

price it in that range. The fact we are all still in business means that over the course of the years we have been fcrtunate in pricing more issues correctly than incorrectly. You only go along a certain period if you price them all wrong.

COMMISSIONER LEMAN: To what extent are you allowed to talk to anyone about what they would pay for a bond or for a certain maturity of XYZ company?

MR. MILNER: Well, the large underwriter who is taking a commitment -- let us use a figure: A $10 million bond issue of a corporate issue: He wants, or his ambition is, to have the large institutions -- the professional buyers have to break the backs of the issue when you get into that size. You cannot sell that issue retail. That type of issue is an issue that institutions -- I am assuming this is for institutional purposes -- and the underwriter during the course of the negotiations discusses with certain of the larger buyers the security they are prepared to bring out, and discusses the rate they are proposing to deal, and those buyers will give an indication, "If it were to come at 98 we would be definitely interested." He has then, not an order, but he has an indication that 98 is a satisfactory price to company A. If companies B, C, D and E all say, "No, we would not even look at it unless it was 97½", then he has to reduce the price. If he determines then in his own mind the concensus is that 98 is too high, he will go to that 97½ figure.

COMMISSIONER LEMAN: But that is as far as he can go -- just a rough indication? He can't before

actually offering practically get a commitment from anybody?

MR. MILNER: Oh, yes; it is quite legal under the Securities Acts to talk to professional buyers prior to an issue being sold to the public, and in some instances you have actually firm orders-- most instances, I would say. I will ask Mr. Sutton to speak to that.

MR. SUTTON: Yes, we are allowed to talk to the banks and life companies and trust companies, and of course we can sound out potential buyers in the United States. So, you can get a pretty fair idea of the institution support for an issue before it actually comes out. Sometimes, of course, opinions differ as to what a proper level is, and if the underwriter disagrees with the institution, this is where the retail force comes in.

COMMISSIONER LEMAN: This is in the area of corporate finance. It is substantially different for other types of issues, like provincials, say?

MR. MILNER: I am going to ask Mr. Ely to speak on that.

MR. ELY: Yes, it is substantially different, Mr. Leman, in connection with provincial issues. You can judge provincial issues and municipal issues very accurately except under most disturbed market conditions, and it is seldom the case where we would discuss with the buyer the pricing of a provincial issue or a municipal issue before coming to market.

COMMISSIONER MACKINTOSH: Is that because there is more trading in them?

MR. ELY: It is because you measure the value of a provincial or municipal issue by the going rate on the Dominion of Canada bonds, and there exists a reasonable spread between those types of securities, but in addition to that the institutions, who, by and large, buy a fair proportion of what we call high-grade issues -- provincial or municipal issues -- would be inclined to want to buy it at the cheapest price possible, and that is not always a good thing for the borrower. So, we rely on our own judgment to price the issue knowing perfectly well it is a fair price both to the borrower and the person who puts up the money, and also with the realization that if we don't sell a fair percentage to the institutional buyers there is a broad market for that type of security elsewhere, and if we were dictated to by the institutions in all cases the borrower would suffer -- except that there may be an exceptional situation where markets were highly disturbed, and then perhaps you might change the rules.

COMMISSIONER LEMAN: To revert to the other factor we were discussing relative to corporate finance, in, say, a provincial issue is an underwriter committed for a longer period before the offering than in the case of a corporation bond, or the other way around?

MR. ELY: No, an underwriter would be unwise to commit himself either in a corporate issue or a provincial issue or a large municipal issue except immediately before he comes to the market.

COMMISSIONER LEMAN: So, in either case, be it a provincial issue or a corporate issue, the period

is very short before offering?

MR. ELY: I would say as a general rule you commit yourself on a corporate issue the day before you go to market, and on a provincial issue you commit yourself the day you go to market.

COMMISSIONER LEMAN: What happens if you bid when there is a bidding process for, say, a municipal issue? Between the time you have put in your bid and the time you offer -- what length of time -- what interval is that?

MR. ELY; About half an hour. We will put in our bid -- say, you are bidding on a provincial issue or a municipal issue, and the bids are called for three o'clock: We would usually send a letter to the borrowing body with no price in it. We would drop that price in maybe an hour ahead of the meeting or half an hour, and in another half an hour we would know whether we had bought it or not and we would be going to market.

MR. MILNER: Excuse me for interrupting, Mr. Ely, but just to make sure you have this explanation, Mr. Ely is referring to provincial issues and the top grade of municipal issues such as Toronto, Montreal and that type of security. When you get into the smaller municipals there is often considerable delay after the tender, after you have bought it by public tender, before you can get sufficient data from the municipality to be able to make a proper public offering, particularly on small municipals. You do your utmost to get in advance as much as you can, but there is a delay on municipal issues.

MR. ELY: But not of any great duration; it may be a matter of hours.

MR. MILNER: It may take a day to get the proper figures.

MR. JOHNSON: It may take a day to get your prospectus lined up with the proper statistics, but your salesmen would be offering immediately. There is no prospectus required on a municipal issue, but you often may be subject to a satisfactory prospectus -- there would be no delay.

MR. MILNER: But there is a delay that occurs if you have not got proper statistics, if he says, "Come back when you have the proper statistics".

COMMISSIONER BROWN: I hope there is not a suggestion you are making up your bid without statistics.

MR. ELY; By and large, you just don't bid if you haven't got proper statistics.

COMMISSIONER GIBSON: Mr. Ely, you say there is a fairly well established differential between Canada bonds and provincials and high-grade municipals: Do these vary much, or are they fairly well set?

MR. ELY; They are reasonably well set. They vary under certain circumstances. Perhaps one could say there is a yardstick between comparable maturities of Dominion of Canada and provincials and municipalities of higher grade under certain given market conditions. The variation takes place, either widens or otherwise, according to the conduct of the borrower and the view the investor takes of that borrower.

COMMISSIONER GIBSON: So the supply of various kinds of security on the market would make a difference?

MR. ELY; Supply and demand always make a difference, and I know you realize that. It could be a worthy provincial borrower might be able to borrow for comparable maturity at one-quarter of one per cent below a comparable Dominion,and he might still be very worthy, but because of the weight of borrowing -- the weight of money he has to raise in a particular time, the spread might be forced -- it might be forced to a wider spread. Yet, on the other hand , you get the reverse.

COMMISSIONER GIBSON: So the area of decision, in making a bid at any given moment, is pretty narrow in range?

MR. ELY: Very.

COMMISSIONER GIBSON: What sort of thing -- one-eight or one-quarter, when you are trying to figure this out?

MR. ELY: I would think as a yardstick perhaps one-quarter of one per cent between Dominion of Canada bonds and worthy provincial borrowers, and perhaps another 15 cents, 25 cents in yield when you step down to the municipal field, depending on the borrower.

COMMISSIONER GIBSON: The question I was really getting was, when you make a bid you are thinking in terms of a possible range of price that you bid?

MR. ELY: That is right.

COMMISSIONER GIBSON: This is a very narrow range?

MR. ELY: Very narrow.

COMMISSIONER GIBSON: Most of these larger provincial operations are done on a group system?

MR. ELY; That is right.

COMMISSIONER GIBSON: A syndicate system?

MR. ELY: That is right.

COMMISSIONER GIBSON: And some of them are bid, though -- what sort of range do you have on the bids where there are bids on a provincial issue?

MR. ELY: Most of the larger provinces have found to their satisfaction that it is better to go the negotiated route, but when you get smaller provinces, for example, Prince Edward Island, there would be several bids and the range would be very narrow.

COMMISSIONER GIBSON: It would be less than one-eighth of one per cent on yield basis?

MR. ELY: Yes.

MR. MILNER: Much less.

MR. ELY: It would be more in the range of half of one per cent, which would be .05.

COMMISSIONER GIBSON: Oh, on price?

MR. ELY: On price.

MR. MILNER: It would be somewhere about .05 on yield. There could be some very low bid that some person puts in who didn't want them but who wanted to bid.

MR. ELY: Or didn't have any real ideas of the value.

COMMISSIONER MACKINTOSH: I seem to remember we got complaints from one province who had carried

on its business in exemplary fashion and they had great difficulty overcoming the ideas of the industry as to what the spread ought to be on their bonds as compared with other provinces, and the ideas of the institutions as to what quota of their bonds they ought to hold. They felt they got slight reward for 8 or 10 years of right-doing.

MR. SHAW: That is quite a long period.

MR. ELY; I don't quite understand that question.

COMMISSIONER MACKINTOSH: The provinces are not all in the same range?

MR. ELY: That is right.

COMMISSIONER MACKINTOSH: Is there not a grading among provinces?

MR. ELY; The market-place grades them according to their performance.

MR. MILNER: You must remember, Dr. Mackintosh, we are only intermediaries between the borrower and the lender, and we have to know, in order to be successful where the lender is willing to lend the money, and if he differentiates between two provinces, possibly wrongly even in our opinion, nevertheless we are forced to abide where we know the bonds can be sold or the price they can be sold at.

COMMISSIONER MACKINTOSH: Your answer is that the complaint is against the market?

MR. MILNER: We have no control over -- we have a control to this extent, that we are doing our utmost to do business and we are trying to show there

is real value in the securities we are offering, but up to a point that is as far as we can go. We cannot force people to buy two securities at an equal price.

COMMISSIONER LEMAN: What role can you play, for instance, in improving the market for a province, for a municipality?

MR. MILNER: Let me give you an example -- this is a concrete example over a period of ten years: We did a very large amount of business in the syndicate we are members of in selling Province of Saskatchewan bonds in the American market, and the province at our instigation prepared a vast amount of statistics and we took the provincial treasurer of the province all around to the various buyers and they discussed it between themselves -- how the province was doing, the explanations -- and that has worked out in a number of instances very favourably. Another way of doing it-- speaking still on the American type of distribution -- some of our firms have asked a dozen or so of the American treasurers of insurance companies to come up to Canada and have taken them on tours showing them the conditions in the various municipalities and provinces, and that type of what we call sales propaganda, we feel, pays off very handsomely.

COMMISSIONER LEMAN: Are there some specific techniques used also? I would like to refer you for a minute to paragraph A.47 at page 16 of the A section. At the end of that paragraph you were there talking about municipal finance and you say:

> "As long as a municipality is willing to use a negotiated type of underwriting instead of the bid system and the syndicate can prepare a good reception for each new issue".

Are there preparation techniques used or what are you referring to there?

MR. MILNER: Well, Mr. Leman, let me put it this way: if a smaller municipality brings an issue up for tender, let us say there are ten municipalities coming up for tender during the next ten day's time, and there are 25 firms all intending to tender for these municipalities, the cost of the preparing of the data in order to come to market, if you do not buy one of them it is a dead loss. In other words, all your circulars et cetera are obsolete as you did not buy the issue, but on the negotiated deals where you know you are going to get the issue you keep the statistics completely up to date so that you can enter the market really on a minute's notice.

In cities like Toronto, Regina, Ottawa, the syndicate managers of these negotiated deals are always in touch with the municipalities and their information is right up to date, but in smaller ones that is not the case and when you are selling smaller

municipalities to professional buyers, speaking now of the insurance companies who are the true professional buyers of municipalities, they will argue with you that with two municipalities there is a difference of a fraction of a percent yield between two municipalities. How they ever can arrive at whether Guelph or Galt has that fine a distinction I do not know, but they will have certain rules and each one has a different rule. Some people want a large amount of industrial assessment; some institutions say: "No, we prefer a large amount of household units, not apartment houses, we like cities with nothing but houses in them", and all those varying factors come into play in the bidding and in the selling, so that in your smaller municipalities there is just as much differentiation until you get down to the ones that are very, very difficult, like your local municipalities in the west particularly -- in Saskatchewan, Alberta and Manitoba and you get rural school districts. It is very difficult to obtain the proper statistics for those municipalities in advance.

COMMISSIONER LEMAN: Mr. Milner, I asked what could you do and what do you do to "prepare a good reception for each new issue". What are the procedures that prepare a good reception for a new issue? Are you allowed to operate in the secondary market?

MR. MILNER: No, there is no secondary market on municipalities, or practically no secondary market on municipalities as such. The buyers of muni-

cipalities are buying a rate of interest over a period of years. They mature the bonds in the normal course of events unless there is some very wide spread in market rates in between. But we do our best to educate the buyers of municipalities securities as to their relative worth. I do not think I would go any further than that. That is about as far as we can go. The institutions are the important ones and it is our knowledge of the requirements that they need that help us in bidding and we can assist the municipalities in preparing reports that are satisfactory to those buyers. We get the local treasurer to give all types of statistical information that is not available in the normal information that they keep for public record.

COMMISSIONER LEMAN: So this preparation process you are referring to in this particular paragraph is just a question of preparing a good circular, for instance?

MR. MILNER: That is true.

COMMISSIONER LEMAN: Nothing in the market as such.

MR. MILNER: Nothing in the market.

COMMISSIONER LEMAN: Now, we have talked a few minutes ago about the short length of time that a commitment is made before an issue goes to market. In view of the fact that in practically all areas provincial, municipal and corporate, there has been a tendency for borrowings to be larger than they used to be, the sizes and the level of expenditure of each type of borrower -- has the size of underwriting been

hampered a little bit by reason of the capital available to the underwriters? Has that been at all a confining problem?

MR. BEATTY: The underwriter's own capital?

COMMISSIONER LEMAN: Yes.

MR. MILNER: No, I do not think by and large -- the underwriters that underwrite securities, in my opinion at least, have sufficient working capital or assets to cover all the liabilities they take on and if the municipalities get too large an issue for one dealer to handle he will join with another dealer or two or three dealers in order to share that liability.

COMMISSIONER LEMAN: Well, what impressed me, Mr. Milner, over the years is that in the United States, for instance, for a given size of issue -- I am talking about large ones, let us say $50 million and up -- generally the underwriting group is much larger in the States than it is in Canada. Why is that? I have seen underwritings in the corporate finance field of $75 million or $100 million divided among 150 underwriting firms whereas in Canada the syndicate groups are never that large, are they?

MR. MILNER: No, but, Mr. Leman, if you are referring to the American market, the American market is a far larger market even relatively than ours is and the liability factor is of much more importance in the American market than it is here because they will be bidding there not on your $50 million or $60 million issue, but on six issues during one week totally $260 million, so they of necessity must get more

and more people into their underwriting groups in order to share that liability.

Here in Canada our working capital -- I assume that the working capital of our industry is as high as the corresponding American working capital taking it over the whole range now -- not talking about Morgan-Stanleys -- but just relatively speaking the one phase of having to bid on six issues in one week, the placing of issues in Canada is different from the American market. There is a much broader market.

COMMISSIONER LEMAN: Would you say in relation to the capital available to them in the States, relative to the liability that they have on risk at any one time, the relationship is about the same?

MR.MILNER: About the same, I should think.

COMMISSIONER LEMAN: Due to this number of undertakings or commitments in a short period of time?

MR. MILNER: That is correct.

COMMISSIONER LEMAN: But would the larger capital in the hands of the underwriter enable the underwriter to take a risk over a longer period of time, for instance?

MR. MILNER: I think that the average underwriter in Canada wants to limit his liabilities purposely. He does not want to buy everything that is offered. He is content to do what he regards as his share of the business. There has never been any lack of working capital that has restricted any

of the bidding I have seen in Canada.

MR. SHAW: I think on that, if I may Mr. Milner, it just is not the same business, to carry any liabilities for any length of time, because your market does change so quickly. The important point is to underwrite your issue and sell it as soon as possible.

COMMISSIONER LEMAN: What I am trying to gauge is what the real reason is.

MR. SUTTON: The reason is really the change in the market.

MR. SHAW: And that is where the losses occur over a period of years, it is in the issues that have been undigested within the normal market period that the normal losses when they do occur can far outrun the margin of safety you provided in your pricing to provide for that risk factor, and that has occurred in all sections of the market in the memories of all of us. We have lost substantial amounts of money in what could be considered good provincial issues which were placed at the time too tightly for the then existing market and before you could get them to the market the market had fallen away from you and you would wind up with losses that would far outrun the profits in that same province over a period of several years of underwriting.

COMMISSIONER LEMAN: Is there some difficulty in defining and measuring exactly what one would call losses on underwriting? Is that a clear, precise term or a little vague? In other words, you might have to

sell a bond you had paid so much for and sell it at a point or two less. That is a clear loss. You might consider that you had suffered a loss if you carried that bond for a length of time you had not expected to carry it, but are there any statistics on losses on underwritings in the industry?

MR. SHAW: There are in the individual companies. I would not think they would be available on an association basis. Each of us knows how we have done at the end of the year on our underwriting business and we would hope that we would keep to a minimum those cases where you did distribute the whole issue at your cost or better. But they do occur and I think it would be a safe statement that in the American market there is much more of a tendency and they have had more of an experience -- which might partially answer your previous question -- where, if the market moves against them they are very quick to take their losses and move out, and it is not at all unusual to see an issue having come out priced at $99.50 and be some 60 per cent sold and see the last 10 per cent sold 2, 2½ points sometimes below, and these are figures that are crossing our desks all the time. We watch the American operations down there and it is a much more frequent occurrence.

COMMISSIONER LEMAN: This occurs much more frequently in the United States than in Canada?

MR. SHAW: Yes, perhaps not relatively but we are talking about a 15 to one ratio, if you like, and because of the size of the market, of the

complexity of the operation we will see occurrences perhaps more frequently in absolute cases than we would see them here. We do not have such statistical or recording cases here so frequently. The point I am making is that it is not at all unusual as you watch the flow of corporate underwritings in the States in a changing market to learn through your American affiliates that this or that particular issue is being cleaned out well below the issued price. Hopefully, every time it is the other way.

COMMISSIONER LEMAN: Why is this? Is that because they take a longer risk in point of time? Certainly you do not mean to imply that the quality of judgment on the market is worse there than here?

MR. BEATTY: It is a question of velocity.

MR.SHAW: I would say that in that larger market those cases emerge more frequently than they will in our smaller market operations.

COMMISSIONER LEMAN: Might it reflect a somewhat tighter underwriting practice there relative to the market? It must reflect something. I think you said it occurred a great deal more in the United States than it does here. What is the cause?

MR. SHAW: May I pursue the answer for a moment, Mr. Milner?

MR. MILNER: Certainly.

MR. SHAW: Is it not related to what Mr. Milner has said, that at any given time one firm down there can be operating in several fields and the possibilities of error are probably greater than here.

[illegible]

We operate much less frequently and we are not forced to take such hurried judgments as might happen down there.

MR. MILNER: And there is one other point. There is a very marked difference in those two markets to the extent that in Canada we have a much broader -- what we call a retail market. I do not mean to say these are Mrs. Smith's and Mrs. Brown's that are necessarily buying, but you have little funds of various kinds in Canada. In the American market, it relies entirely on institutional demand. They have practically no such thing as retail except for tax-exempt municipals.

COMMISSIONER LEMAN: And this type of customer is a tougher customer to sell and to judge ahead of time than the small retail customer in Canada, is that it?

MR. MILNER: Yes, the ordinary smaller buyer in Canada is buying a rate of interest. He wants to invest his money at, call it 6 per cent if you like, and you sell it to him at 6 per cent and he is perfectly satisfied. Your corresponding professional American buyer is working on spreads -- he will say "Rather than pay $100 for that bond I only think it is worth $99-3/4" and he will not buy it at $100. We can distribute a lot of our issues here -- I do not mean to say we are distributing at a false value to the public but the public are not trying to purchase an issue for resale the following morning. Some of our institutions do, but the public as a whole here are what I would call long term investors and in the

American market they have no such way of distributing that 20 per cent or 30 per cent of the issue that we have here.

COMMISSIONER MACKINTOSH: I do not really believe that the unsophisticated investor is as large a pillar of strength to this industry as is being indicated from time to time.

MR. SHAW: Is not the difference you were dwelling upon earlier that here in Canada we are different from our counterparts in the States in that many of our firms are integrated and the underwriting firm has its own distributing organization and that does not occur to anything like that extent in the United States? We can take on a whole issue bolstered by the knowledge that you have a distributing organization through the country through whom you can distribute and place your securities. That does not occur in the United States market. The underwriting used in most cases is to underwrite and distribute to other houses or directly into the institutions and move on to the next and if they are caught with an issue they do not have their own retailing organization to help them place it.

COMMISSIONER MACKINTOSH: It all comes back to what Mr. Milner said, does it not, that they have six issues coming up in a week and it pays them better to get on to the next job and make their profit out of that rather than to keep a dead duck around trying to recoup some possible loss there?

COMMISSIONER LEMAN: On the other hand, there

are more people working at this judgment of the market all the time down there than there are here, and that is probably in proportion to the number of issues going out, is it not?

MR.WADDS: There are more people working in the market. There is no question about that, but the sheer velocity of these issues in the United States and the rapidity with which your utilities market, for instance, changes in price is such that overnight a piece of merchandise that looked attractive yesterday could have broken a half a point. People do not want their liabilities to pile up too quickly so they get out and the market changes very rapidly.

COMMISSIONER BROWN: The Canadian market to a large extent being a retail market is less sensitive too?

MR. WADDS: I would say that is right.

MR. MILNER: Providing that you realize that the word "retail" is not referring to individuals. The retail is what we call not large, or whatever you want to call them -- large institutions. It is the 250 small ones under that top 50 that absorb a lot of our securities here.

MR. HUNTER: Might I also mention that in the United States market practice seems to be that new issues are bought for cash in most instances whereas on the Canadian market there is a much greater tendency to trade out other securities. The flow of cash here is not as great, and we take over securities quite frequently which people are prepared to sell to buy the new issue and this tends to place the new issue fairly satisfactorily.

COMMISSIONER GIBSON: Does this mean that the American investing public have much less taste for fixed income securities than the Canadian investing public?

MR. MILNER: Definitely less because they use the tax municipals for their retail accounts.

COMMISSIONER GIBSON: Somewhere in these papers it has been pointed out that these are mainly pretty rich people which the tax element supports. I would judge from what you say both in the brief and recently that there is a much broader market among the generally lower income levels for fixed income securities in this country than in the United States. Is that a fair statement?

MR. MILNER: I think that is a perfectly

true statement, Mr. Gibson. If you go back in history, during the first world war when we started victory loans we were able to finance both wars by public money to a much greater extent than the United States which has no such means of distributing their public debt in the hands of the small people.

COMMISSIONER GIBSON: I realize that, but you are really saying it applies to municipal and corporations as well?

MR. MILNER: Yes, as well.

COMMISSIONER GIBSON: It is not just the distribution that is involved.

MR. MILNER: It applies to all fixed interest bearing securities. We have a far greater distribution of fixed interest bearing securities in Canada than they have in the United States, far greater.

COMMISSIONER BROWN: Can you give us any theory as to why that is so?

MR. MILNER: I think every one might have a theory about it. It is a matter of history, that is what it amounts to. The American public obviously have a different theory of investing money than the Canadian public does.

COMMISSIONER GIBSON: Maybe they have more aggressive stockbrokers.

MR. MILNER: I think that is probably a fair statement. There has been a lot of criticism in Canada of our being unable to develop our own industries because we cannot raise sufficient risk

capital. People will not invest in risk industries. That is probably a very valid criticism. We lack a certain amount of courage, but the truth of it is at the moment at least that we have a much greater proportion of fixed interest bearing securities held by the public in general than they have in the United States.

MR. ELY: May I speak on that subject for a moment, Mr. Milner?

There is the fundamental reason for this that in United States the government is financed through the medium of setting a price on issues with no commission to the dealers, so therefore no dealers do any public distribution, and why should they? The only time when a dealer participates to any extent in the United States in government issues is when he believes the government has perhaps made a slight error and underpriced it. That is not sound business. In the United States the government does not pay a commission to dealers for the distribution of their issues and therefore they do not get distribution and they did not during the war, so they have lost to themselves a very big public market which we have developed under our system which, in our opinion, is better.

COMMISSIONER GIBSON: You would say then it is more than technique which they have in the nature of investment dealer business? It is the difference in the character and attitude of the population which accounts for this?

MR. ELY: Well, that character of the population to buy fixed income securities in the United States has not been exploited because of the fact that no commission is paid on government issues. This has been developed in this country to a very marked degree.

COMMISSIONER MACKINTOSH: What do the poor Americans do with their money?

MR. SHAW: They buy mutual funds.

MR. ELY: They buy mutual funds and shares and fixed securities find their way into large pools like insurance companies, banks and trust companies.

COMMISSIONER BROWN: And what about the tax free?

MR. ELY: The tax free generally finds their way into the trust company where the trust company is handling the affairs of a wealthy person.

MR. SHAW: It goes back years to the wartime financing of the first and second wars. During the second war we had victory bonds in the hands of one out of every three of the population. The investment dealer industry organized these campaigns and received remuneration for doing so. In the United States your savings bond programs were handled in quite a different way. In no organized way did they mobilize the dealer industry to place the indebtedness of the federal government with the population. Here we did.

COMMISSIONER LEMAN: Is this a form of tax down there to get all these free services for

[illegible]

government issues?

MR. SHAW: Perhaps we were forced to do what we did and they were not. It took a real organizational effort on our part to take over our problem of handling the money in the latter part of the first war and the second war. Their larger markets and larger population did not make it necessary.

COMMISSIONER LEMAN: Now you described the pattern of how these various types of securities are distributed in the economy in the United States as contrasted with what happens in Canada. Could one base a judgment as to which is the more desirable type of distribution on those facts?

MR. SHAW: We think, relating to the age of our economy and stage of development, if you like, that what we have developed here has proven to be very workable. We equally feel that we could not have just borrowed their type of operation because it would not have worked for basic reasons.

MR. ELY: The borrowers in Canada would never have been able to get the kind of money that we have been able to raise had we gone their way.

COMMISSIONER LEMAN: That might have forced the corporate borrowers more into the equity field?

MR. MILNER: Yes, conceivably it could have forced them more into that field. Remember, however, that the United States is a supplier of capital to the world in general and has been a supplier

for a number of years, ever since the end of the first war. We have been a borrower of capital. We have not had sufficient capital in this country to develop with our own money. We have had to borrow outside the country. You have got the same thing in England even still. There is a surplus of investing money in England looking for investments. Here we are on exactly the reverse foot. We have a surplus of investments but lacking buyers.

The development in this distribution market in Canada in my opinion has been one of the greatest things that this country has ever witnessed. I think it has meant that we have financed a lot more of our own internal business than we could have done if we used the American or British methods.

COMMISSIONER LEMAN: Yes, but I thought you had mentioned that there was not enough enthusiasm or demand for equities in Canada as a result of people investing in fixed income securities too much.

MR. MILNER: Oh, I merely said there were some people who felt that we have not properly developed the risk capital market in this country. A number of people have criticized that Canadians as a whole have not been prone to buy risk securities.

I think a perfect example, if you want to put it on a different basis, relates to the complaint for instance among the people in the Maritimes, that the shares of the Bank of Nova Scotia are now spread across the country. The Bank of Nova Scotia was a

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Maritime bank originally, but over the course of the years it all has been redistributed in other parts of Canada merely because the citizens in Nova Scotia apparently were not willing to maintain the investment in their own bank.

COMMISSIONER BROWN: Sometimes those people moved out of Nova Scotia.

MR.MILNER: Yes, some of them did. There is no doubt that there is a weakness in this whole structure of ours for raising what I would call good risk capital. Now, we have no trouble in raising any amount of money for the really high speculative moose pasture capital.

COMMISSIONER BROWN: When you say "we" are you speaking for all the investment dealers?

MR. SHAW: Those other people.

COMMISSIONER LEMAN: Do you think the I.D.A. members could play a role in correcting this?

MR. MILNER: I think we are playing a role. I think if you could analyse our figures as an association,in the past twenty years, you would find the industry as a whole has probably derived 40 per cent of its net profit from selling equity securities whereas twenty years ago it was not even 10 per cent. We have improved tremendously.

COMMISSIONER LEMAN: That is the distribution of new issue equity?

MR.MILNER: No, not necessarily equity securities as such.

COMMISSIONER LEMAN: Including the secondary market?

MR. MILNER: Oh, yes, secondary market.

COMMISSIONER LEMAN: Are there any tax structural problems in the tax field between the two countries that have contributed to this result outside of the special factor of tax exemption on municipals in the United States which we know about? The general structure of taxes is not sufficiently different, is it, to produce that result? In both countries interest in the corporate field for tax purposes is similar?

MR. MILNER: Yes.

COMMISSIONER LEMAN: The corporate tax levels are quite comparable, so are there any tax features that may have produced the result? There has been the effort in Canada through the 20 per cent tax rate that we know of.

MR.MILNER: Our income tax here, if you take it down to the basic fundamentals of the income tax structure, is far higher than the United States income tax, particularly in that bracket of people that can invest money in equity securities. We have, for instance, as an example, that they share theirs with their wives, so the income is cut in half immediately. You simply split it between the two. You do not get the people in the 60 per cent bracket in the United States because they add their wives on to it and cut it down to 30 per cent, and they have higher deductions.

COMMISSIONER LEMAN: Here you are talking about the tax structure from the point of view of the investors. There is no difference from the point of view of the borrowers, is there?

MR. ELY: There is no fundamental difference from the standpoint of the borrower.

COMMISSIONER LEMAN: You have pointed out the differences from the point of view of the individual investor.

MR. BEATTY: The formation of capital for equity investment took place during periods of low income tax or no income tax and there was not a comparable period here.

COMMISSIONER LEMAN: But what Mr. Milner just said seems to argue exactly against the result we have got. If our personal tax structure in your opinion is higher here and if we have the 20 per cent dividend exemption, at least rebate for tax, why do people still have a preference for fixed income securities where they pay more taxes on it?

MR. WADDS: I think we might say they are all perhaps accumulating capital in this country which, as Mr. Beatty said, took place many years ago in the United States under a lower tax structure. It is customary to save some money before you put it into equities. The fixed income securities in this country is a medium savings. I do not think we have sufficient free risk capital in the hands of the individuals to generate this vast equity.

MR. SUTTON: There has been a change. Mr.

Milner mentioned the change in the importance of the equity business to the investment dealers in the last 20 years. I should say most of this has occurred in the last ten years. I think there are perhaps two basic reasons for this. One is that dividend tax credit, and the other is this fact, that we have had a rising stock market and more and more people becoming attracted toward it and putting a higher proportion of their portfolios into it. Both of these have influenced this trend in the last twenty years.

COMMISSIONER BROWN: Would it have anything to do with the relative margin of profit on the underwriting of new issues of debt type securities in the two markets?

MR. SUTTON: No, I do not think so because your risk is greater on the underwriting of common stocks.

COMMISSIONER BROWN: I am speaking about the markets in the United States. Is there a narrow margin on the underwriting of the debt type securities that induces them to take it into institutions?

MR. SUTTON: This again is a reflection of the historical trend that Mr. Ely mentioned. The underwriting margin on large debt security in the United States is smaller than in Canada because it is pretty well marketed to institutions. Whereas, here we do have retail institutions where the costs are higher and therefore the margins are higher. In

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stocks, of course, you have commissions established by the stock exchanges. In the case of mutual funds you have your loading charge of 7 or 8 per cent which compensates and enables it then to reach a larger proportion of the population. This trend has been underway in Canada too.

MR. SHAW: Is there not a danger in this attitude that the Canadian public is too averse to equities; is there not a danger that this is being a bit overdone? When one looks at the job that has been done in Canada over the past certainly ten years in extending the capital for chartered banks; the large rights issues; the additional equities that have come into the utilities through the rights issues; the general field of rights issues -- when all added together during the past few years that represents a significant addition to the equity holdings in Canada, and the greater part of that responsibility for the distribution has rested within our membership. Sometimes I am inclined to be a little irritated with this suggestion that the Canadian is all debt minded or fixed interest minded and has no proper appreciation of the possibilities of equities.

COMMISSIONER BROWN: I think this is something on which we would like to get an opinion expressed. That is, has this historical preference for debt securities in the Canadian individual retail market been a good thing or a poor thing? Has it been in the investors interest or has it not been in the investors

interest?

MR. MILNER: You are asking a question as to whether we think that it is in the best interest of the country?

COMMISSIONER BROWN: There was an indication that it was not a good thing. Let us get an opinion on it.

MR. MILNER: I would think as an association in what we feel -- and I don't want to go back to what I said before -- that in a country that is by nature one of development, we haven't got sufficient capital for our own needs. I think we have raised probably as much capital in this country as is humanly possible by the method presently used. I think it has been a very unfortunate method.

If we had had the other method -- there is no telling what the public would have said about the other method -- but our savings bank deposits, for instance, are very high here, actual savings bank deposits, people who will not even buy bonds but who will simply leave the money on dep@sit, and we think that you are right in saying that there is an untapped reservoir of money in this country which might be used possibly to better advantage to further develop the country, but I think that we at least have got the satisfaction of knowing that we have got the money in the hands of the public.

There may be quite a change in the investment attitude of the public. We witnessed in the past five years, or we have seen a much greater increase in equity securities amongst the public generally and I think that that will continue, but the beautiful part of it is that we have a backlog of fixed interest bearing securities here which we haven't got in the United States.

COMMISSIONER LEMAN: Someone referred to the large pools in the States which are larger than in

Canada. Would you say that in proportion to the total of savings available for capital investment in Canada there is a smaller or a larger proportion of pool funds as against individual investment funds?

MR. MILNER: There is a smaller proportion in Canada of pool funds.

COMMISSIONER LEMAN: A small proportion of the total of this pool in Canada?

MR. SUTTON: Do you mean in the hands of institutions?

COMMISSIONER LEMAN: In the hands of institutions, pension funds and that sort of institutional investment.

MR. MILNER: Mr. Cretzianu, do you want to answer that?

MR. CRETZIANU: The study we have tried to make has been hampered by the lack of statistics, but it has seemed to us from the figures we have been able to find that individual investment in equity is not too different in Canada from the United States.

Samples of family holdings of equities -- granted they are for 1959 -- show that there is about the same proportion of families in the United States holding equities as in Canada and, as has been pointed out, there has been for the past 15 years an increase in the interest by Canadians for equities.

There have been several reasons for that; for the 20 per cent dividend tax credit and recently the suppresion of the 4 per cent surtax, and I must say that the efforts made by the Investment Dealers' have an effect in getting interest in Canadian equities

on their part. This has taken the form, among other things, of a great increase of reserves and in development of encouragement to would-be investors.

On the other hand, the figures we have been able to gather on the investment of life insurance companies and of pension funds and trust companies have proven that it is in this sector that the holding of equities is lower in Canada than in the United States. The totals we have produced, which you will find in Appendix J -- are somewhat sketchy and the comparisons are perhaps not all valid, but I think they prove the point that it is in that sector that the holdings of equities is perhaps much lower than in the United States.

COMMISSIONER LEMAN: Thank you for that information, but that wasn't exactly the point I was raising. What I was groping for was this; out of the total amount available for investment in the two countries, would you say that there is a higher proportion concentrated into institutions -- pool funds, we call them -- in the States than in Canada, or the other way around? Is the individual investor a larger proportion of the market here than in the States, or vice versa?

MR. CRETZIANU: I am afraid I am not able to answer.

MR. MILNER: Could we have this question asked this afternoon?

THE CHAIRMAN: I think it is about time for an adjournment anyway.

COMMISSIONER MACKINTOSH: We would be delighted to have it answered this afternoon.

THE CHAIRMAN: We will adjourn now until 2.00 o'clock.

--- Luncheon Adjournment.

--- On resuming at 2.00 P.M.

COMMISSIONER LEMAN: We have no doubt you are probably enjoying this as much as we are, but it would seem we got carried away a little this morning with subjects that do not make the line of questioning too logical, so I would like to get back a bit to the technique of underwriting as such against the results obtained during the last few years in the Canadian market. There are numerous references in your brief to the formation of syndicates among I.D.A. members for underwriting purposes, and I think you describe fairly well for what purpose these syndicates are formed. What governs the choice of partners or members of the syndicate generally?

MR. BEATTY: I would like Mr. Ely to field that one.

MR. ELY: By and large, Mr. Leman, the things that govern the formation of a syndicate are the financial strength of the members, their ability to distribute the kind of securities that are under discussion for that particular syndicate. When you form an underwriting syndicate you are forming it on a piece of merchandise and you will use different houses for different reasons on different types of merchandise.

Would you like to be specific on a certain type of vehicle? Would you like to know how we form a syndicate on a provincial issue or a municipal issue or a corporate issue?

COMMISSIONER LEMAN: Well, if your general

statement at the beginning was to the effect that it is the distribution ability of the various firms for the particular securities ---

MR. ELY: By and large, that is it.

COMMISSIONER LEMAN: Very well. However, things are not always static in this industry. Do these syndicates tend to stick or is there some variation from time to time on one issue after another of the same type? Are syndicates formed for each new issue, or do they tend to be traditional?

MR. ELY; By and large, they tend to be traditional unless there is good reason to change them, because some of the members have either gained in distributing power or lost some of it, gained in financial stability or lost some of it, and from time to time as the issues are getting larger syndicates have been added to.

The best example of that, I think, would be the Province of Quebec. I haven't got the figures at my fingertips, but I think when that syndicate was formed -- I think about three years ago or two years ago -- there were perhaps 30 in the syndicate, and I think it is now nearer 50 -- over 50.

COMMISSIONER LEMAN: On this score what I am wondering about is whether there is a bit of a vicious circle involved and the distribution ability of certain firms is the criterion used for their participation in certain syndicates. Does their distribution tend to be helped by the fact they already do belong to certain syndicates, and is it

more difficult for someone who does not belong to the best syndicates, who get the best issues, to get the distribution that would qualify them?

MR. ELY: I think that is perhaps a good point. By and large, the syndicates that have been put together in the past and which are continuously being put together usually comprise those people who have the criteria I spoke about plus those dealers who normally take liabilities. There is a segment of our industry that carries liabilities at all times and there is a segment that does not. By and large, syndicates are made up of people who normally take liabilities for their own account -- have the financial resources to do so. So, when a syndicate, to use a term, goes on the line to purchase an issue outright, no matter what happens we know that issue will be picked up and the borrower will be paid.

COMMISSIONER LEMAN: But the phenomenon I was describing does apply a little bit?

MR. ELY: Oh yes, I would be the first one to admit that some traditional things are difficult to break from time to time, but they are broken as time goes on; the emphasis changes; one tries to put the emphasis on the formation of the syndicate being made up of people who today have the financial responsibility.

COMMISSIONER LEMAN: And again, this is a field where an individual firm -- it is strictly negotiation? There is no arbitration, there is no form of appeal or anything like that?

MR. BEATTY: The Association has no part in this.

MR. ELY: It is purely negotiation between the syndicate manager or managers and the firm involved.

COMMISSIONER LEMAN: Well, when you belong to a certain syndicate for a certain type of security that has been existing for some time, to what extent are the partners consulted about the price and terms of the issue? Is it generally the manager of the syndicate who determines all this in negotiation with the borrower and then tells the syndicate members what it is there is to distribute and on which they have to take a position? To what extent do they make a specific decision on this particular issue to take their normal participation?

MR. ELY: The steps are these: The manager or managers -- and in some cases there are joint managers -- first negotiate with the borrower his money requirements, time of coming to the market and approximate area of price, and then usually -- I am now talking about other than corporate issues, although I can go into that any time -- it is then usual to get together the senior members of the syndicate for serious consultation on the amount and the price, and when they are all in agreement that the amount is right and the price is right, then the manager or managers go back to the borrower and negotiate the deal. They then take the whole deal to the entire underwriting group who at that time have their say on the pricing of the issue and the size of

it before the final liability is taken.

COMMISSIONER LEMAN: This is all done within a matter of hours?

MR. ELY: Hours. Sometimes negotiations may go on for some time -- some days ahead of time, between the manager or managers and the borrower, on the one hand the syndicate managers giving the best kind of advice and service to the borrower, and on the other hand perhaps trying to fit the borrower into the proper place in the market so he does not run up against another borrower of similar character or size.

COMMISSIONER LEMAN: In a few places in the brief -- and again I haven't got my references at hand -- you have expressed some concern over the quality of the securities that are distributed by firms and you say that you feel a strong responsibility for this sort of thing because your name is tied to various issues that come on the market. Can there be an element of conflict of interests sometimes between your position as an underwriter and your position as a distributor?

MR. ELY; I suppose there could be, but the question has seldom arisen because I think we are the intermediary and it would be the view of the dealers, I believe, that if they bring an issue to the market that is properly priced both the buyer and the seller get good value. In some instances we are -- I now move more to corporate issues -- in some instances I think it is the view of the whole industry that there are certain types of corporate

securities that are perhaps more suited to certain types of investors and we channel our efforts down that line. There are certain people that really cannot afford to buy at risk. There are others who can and are willing to.

COMMISSIONER LEMAN: In short, it is your responsbility, and you accept it all along the line?

MR. ELY: We accept those responsibilities.

COMMISSIONER LEMAN: Yesterday and the day before we discussed a little bit of this whole system with the Life Officers Association and they expressed a little bit of -- I would not say a complaint, but a little bit of dissatisfaction with the so-called exempt list. How is the exempt list arrived at? Again, you might differentiate between the various types of securities.

MR. ELY; There would seldom be any differentiation. An exempt list, as our industry understands it, is made up of all the insurance companies, all the trust companies, all the banks and perhaps in some cases certain other large accounts that are peculiar to that issue. To put it clearer to you, the Workmen's Compensation Board of a province may be on the exempt list for an issue of that province, but it would not be on the exempt list for the issue of another province and, by and large, an exempt list consists of the institutions I have referred to.

COMMISSIONER LEMAN: But as between one issue and another, would there be a certain percentage of the issue reserved for the exempt list and a completely

different percentage for some other issue?

MR. ELY: Yes.

COMMISSIONER LEMAN: How do you decide how much to leave -- just your judgment?

MR. ELY: From time to time the borrower wants to raise money and it is the job of the dealer to bring about a transaction at the proper level for the borrower and the buyer. At that time -- and it has happened many times -- the so-called exempt institutions may have a different view on the market, may have been putting all their money into mortgages and have no money for bonds. For various reasons they do not support the issue, nor are they interested in the liability that the dealer has. It is not their liability. They support or not as they see fit, so that the amount that one sets aside for the so-called exempt list is modified in almost every issue according to our views on the market and how many the institutions will buy. There have been many occasions when -- and provincial issues are a good example -- on a $50 million issue the institutions, insurance companies in particular, have purchased as little as $3 million out of the $50 million issue, and no matter what we have set aside for them they were not the slightest bit interested. It was then our job, knowing we brought the issue to the market at a proper price, to find other buyers, which we do.

COMMISSIONER LEMAN: So it is an ad hoc decision in each case?

MR. ELY: It is an ad hoc decision, by and

large, out of our knowledge.

COMMISSIONER LEMAN: Does it have anything to do with the other references you make to the need for the type of distribution that you feel would be desirable to provide a market thereafter? We get the impression from the insurance companies, and I think from your brief too, that the insurance companies in general are not great traders in debt securities?

MR. ELY: That is wrong.

MR. BEATTY: That is wrong. They are very active.

COMMISSIONER LEMAN: Don't you feel a tendency on their part to hold on to securities that seem satisfactory to them until they become shorts?

MR. ELY; Not necessarily. If you look at the portfolios of the insurance companies you will see that is not so. It is so in the case of corporate securities, by and large, but not entirely, but in the case of provincial securities it is certainly not so. Without any figures in front of me I would say that insurance companies are not always permanent investors in provincial securities. They are inclined to turn them out to buy something else if they think the price is right.

COMMISSIONER LEMAN: They gave us some actual figures to the amount of trading compared to the amount of new investments they make year by year, and they didn't seem to be very high traders.

MR. ELY: Were these on an industry basis or

an individual company basis?

COMMISSIONER LEMAN: On an industry basis. They admitted some of them traded a great deal more than others.

MR. JOHNSON: Are they talking about trading at the time of a new issue or between new issues?

COMMISSIONER MACKINTOSH: They were speaking of new issues as contrasted with the trading.

MR. ELY: You can differentiate between insurance companies, and I think the industry will go along with me that there are some insurance companies that, by and large, the securities they buy they hold; there are other insurance companies that are certainly the opposite.

COMMISSIONER MACKINTOSH: This is what they said, that some of them were traders and some were not.

MR. ELY: That is true.

MR. BEATTY: I believe they were not unanimous in their view as to the desirability of exempt lists as opposed to free operation on the market.

COMMISSIONER LEMAN: I think there was a little bit of difference of opinion on that score.

COMMISSIONER MACKINTOSH: We don't expect any industry to be unanimous.

COMMISSIONER LEMAN: In any event, is it your answer to my original question that from the point of view of distribution it does not have too much importance whether a large percentage of an issue goes to institutions or a smaller percentage from the

point of view of the market that will be created thereby later for securities?

MR. ELY: No, I don't think so; there is not too much importance. Also, the point I was trying to make is that we could never be in the position of setting aside arbitrarily a percentage of an issue for institutions because as many times as not they would not buy that percentage.

COMMISSIONER LEMAN: We will want later to come back again to some more specific features of corporate and municipal and provincial finance on this general subject of the technique of underwriting, and unless there are other questions, I would like to pass on.

COMMISSIONER GIBSON: Just one point: How do institutions get on the exempt list? Do they ask to be put on? Who decides?

MR. ELY: We decide.

COMMISSIONER GIBSON: You simply decide in each individual case?

MR. ELY: In some cases there have been -- we decide what institution we put on the exempt list and, by and large, we put all insurance companies, all banks, all trust companies and certain other large situations or individual issues.

COMMISSIONER GIBSON: And the others are on the ability circumstances?

MR. ELY: That is right. Under certain circumstances we have had various people who are not an insurance company or a bank, or maybe a pension fund

that has grown big enough that they want to be on an exempt list and they have asked us if we will put them on. By and large, we agree. There are certain large accounts that could almost be considered in the institutional field who do not want to be on the exempt list and have asked us not to put them on. By and large, we agree.

COMMISSIONER LEMAN: Who gets the spread there on the bonds or the securities that are sold to the exempt list?

MR. ELY: The profit that is made on securities that are sold to an exempt list is divided between the entire underwriting group in proportion to their percentage interest in that group.

COMMISSIONER BROWN: Can we clarify that: You said "the entire underwriting group". You mean the banking group?

MR. ELY: Yes, I mean the banking group. When I said "underwriting group" I meant the purchase group -- it is really the banking group. There are two groups, usually: A banking group headed by a manager or managers buy the issue. Whatever proportion is sold to the exempt list, the profit on that proportion is given to the complete institution on the basis of their participation in the group and their liability.

COMMISSIONER LEMAN: I just approach the next subject a little bit by talking about the conflict of interest. I would like to ask you a few questions now about the amount of regulation in the industry from two points of view and really there will be a further subdivision later about the types of securities. The regulation within the industry, what we might call self regulation, comes from the industry, does it? You describe in here that this Association does carry out a certain amount of policing work in the industry. Are there statistics available on the amount of disciplinary action that has had to be taken from time to time?

MR. GASSARD: The number of cases is certainly small. We have been complimented on many occasions by provincial securities commissions for the handful of cases that appear before them. In fact, I think one commissioner said that he never had had occasion to involve a member of our association in a disciplinary case. If, say, the Ontario Commission receives a complaint from a member of the public, it is then referred to the Association who place it in the hands of the discipline committee.

Each district has a discipline committee which is composed of the five immediate past chairmen of the district who are not past presidents of the Association and an appeal from their decision can be taken to the national business conduct committee which is composed of the immediate five past presidents of the Association. The procedure is to lay a charge,

[illegible]

permit the accused to attend with counsel, if necessary, hear his defense and ask him questions and then to later consider the evidence and bring down a decision. There is one other thing. I, as the senior permanent official, am an ex officio member of each district discipline committee more or less to hold a watching brief for the president who has certain powers to review district discipline committee decisions where he thinks they are too lenient or too onerous, and then we report back, if the complaint originated with the securities commission, the decision and what action we have taken. But these cases are very, very infrequent. I do not know that I can add much to that, Mr. Leman.

COMMISSIONER LEMAN: Are there difficulties arising from the fact that it is the industry that has to do that part of the regulating?

MR. GASSARD: In what direction -- the difficulty?

COMMISSIONER LEMAN: Well, in the direction of the fact that they have to take action against their own members to a large extent?

MR. GASSARD: Well, just as a personal observation I have been very much impressed with the due deliberation and the objectivity with which our committees have approached their work and, of course, we do have our counsel there but, for instance, in Mr. Beatty and Mr. Shaw we have two district chairmen who have presided over such hearings and I think you

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could get their reactions. In other words, you have ten people around a table representing various viewpoints and different types of businesses and they, in my judgment, come out to a pretty reasonable conclusion on the cases.

COMMISSIONER LEMAN: I might make one general remark or question. We have received as supplements to the brief some extracts from the by-laws of the Association and some extracts from the regulations. Is there a good office consolidation type of book containing all this material complete, because I find it a little difficult to read?

MR. GASSARD: It is at the printers now and should be available this summer.

MR. MILNER: Well, Mr. Leman, at the beginning of starting a year ago in September, the Association changed its entire by-laws on membership and on discipline. That was when these new regulations came in and, of course, changing them to the extent that they were changed it meant that under our regulations we have the power to pass -- the national executive has the power to pass by-laws during the course of the year but they have them ratified at the annual meeting. This is different from the two stock exchanges. The Montreal and Toronto stock exchanges have to have any of their by-laws changed by a meeting of the members only; they cannot do it by the committee passing it temporarily except by resolution and the rewriting of these by-laws was such a big task that we were fully aware that certain changes would have to be made by

experience during the year. So that at the annual meeting in June there was a long list of minor changes and that is the reason we have not been able to submit to you the final document with the changes, but it should be ready when?

MR. GASSARD: I would say August.

MR. MILNER: In the next month you will have a complete list of our by-laws, the two you are interested in, membership and discipline.

COMMISSIONER LEMAN: And regulations?

MR. GASSARD: Yes.

COMMISSIONER LEMAN: That will be the blue book?

MR. GASSARD: Yes.

THE CHAIRMAN: It is a sort of incorporated body, is it?

MR. MILNER: No, we are unincorporated.

THE CHAIRMAN: Any person who is not a member would not be prohibited from carrying on the business of an investment dealer if he wished, would he?

MR. MILNER: That is correct.

THE CHAIRMAN: It is not a closed corporation?

MR. MILNER: It is not a closed corporation like the stock exchange. For instance, the Toronto stock exchange is incorporated by private bill and I believe the Montreal stock exchange also.

THE CHAIRMAN: Yes, and there are various professional organizations that are given certain privileges by statute. You can only practice medicine

when you are a member of the Association. Yours is not that sort of organization?

MR. MILNER: No.

COMMISSIONER LEMAN: Well, that leads to a question, what is the advantage of being a member of the Investment Dealers' Association to exercise the profession except the privilege of putting the fact on your door?

MR. MILNER: Well, quite frankly, Mr. Leman, there has been a discussion for the last four or five years as to whether we should not become an incorporated body such as the law societies and medical societies having an actual legal entity. When it started it was my understanding (this goes back 25 or 30 years) that the original conception was it was merely a group of people who got together who were in a similar business and they did not want to run the risk of being something that could be attacked in the courts as an entity. I think it might be a fair statement to say that we might be better off if we had the other type of power that could be granted as a society.

Now, we are faced with being unable to say we are the only people who are investment dealers although we have gone as far as to get the co-operation of the securities commissions in the listings, for instance, in telephone directories and that type of thing where we are classified separately from hundreds of other people who might sell anything from real estate up or down.

MR. GASSARD: The term "investment dealer" is a defined term under the Ontario Securities Act, as Mr. Porter knows, under the Alberta and Saskatchewan Act. The Quebec Act, while it is very similar to the Ontario Act, does not refer to the term "investment dealer"; it refers to "brokers". So that in those three jurisdictions I have mentioned and now more recently British Columbia jurisdiction, the Investment Dealers' Association perhaps have a better chance or a better environment in which to develop an image in the public mind of the investment dealer as an ethical, competent, professional person who is devoted to the concept of self regulation.

In fact, the Ontario Securities Act charges us with certain responsibilities in return for certain privileges and it is our ideal and goal to so comport ourselves that those privileges will remain with us.

COMMISSIONER BROWN: Would you outline what those privileges are?

MR. GASSARD: Well, basically I think it is correct to say that the investment dealing business as compared to life insurance business or banking business enjoys greater freedom from legislative requirements and we believe that freedom is more likely to be maintained if we so conduct ourselves that we place the interest of our clients in first place and try to develop in our sales staffs and the staffs generally who serve the public an awareness of our obligations in return for the position we have

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[illegible]

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been allowed to occupy.

COMMISSIONER LEMAN: Are you describing the privileges there or the obligations?

MR. GASSARD: Well, they are two sides of the same coin.

MR. BEATTY: It is a privilege to the extent that our business is rather a technical one and we feel that we can regulate the ethical conduct of our members far more ably than less informed people who are not aware of the day to day technicalities involved in our business and in maintaining the higher standards than would be possible through government regulation we can create a better image and carry on our business more successfully. To this extent it is a privilege.

COMMISSIONER MacKEEN: You might have certain advantages as regards the Bank of Canada, for instance?

MR. BEATTY: Yes, it is more a matter of practice than legal regulation.

COMMISSIONER LEMAN: Well, in the policing area, how is it done? What methods are used? Is there a systematic form of policing work done or do the staff of the commission just wait until there are complaints or reports of unethical practices and bring cases? How do these cases come to your attention -- from complaints from the public or one member telling on another, or what?

MR. BEATTY: They come from complaints

from the public, complaints from securities commissions and from periodic spot checks of the nature of the business of our members. Earlier we told you that 20 per cent of our membership reported each year on the nature of their business. Such cases would come to light through these periodic checks. They could come up through the audit committee.

COMMISSIONER LEMAN: Are there cases where you have to make arrangements or where you do make arrangements with the securities commissions about who is going to take action in a certain case? Is there an area there where it is not quite certain whether they should take action or you?

MR. BEATTY: In all the recent cases I am aware of the securities commission have been quite happy to have us look after the matter. They prefer it that way.

MR. MILNER: There is a big, broad field, Mr. Leman, that is not in any shape or form criminal, if that is the right term to use, but is unethical. For instance, we have had occasions where some of our members have published what we deemed to be unethical circulars. I do not think any court of law could attack it but we feel that they are not the right way to be presented to the public and that is the type of minor disciplinary action we can take to be sure that those people do not use the mails or the public advertisements to the detriment, we believe, of our industry or to the detriment of investors.

THE CHAIRMAN: I suppose the advantage to members of the Association is that they become known as members of an association which is governing itself and imposing certain standards upon its members and what amounts to perhaps a code of ethics which was perhaps agreed to and that that gives the whole membership of the Association a prestige in the eyes of the public and people prefer to deal with people who are members of an association of this kind rather than a person who is not admitted for some reason?

MR. MILNER: That is exactly the purpose we have in mind with our disciplinary actions, to try to be sure that our image to the public is as clear as it is possible to be.

MR. GASSARD: May I add, Mr. President, one of the major functions of our president is to carry this image abroad both to the members and to the public. Mr. Beatty will be starting his presidential travels early in September and he will have a number of messages to carry to the members which he addresses in a general group of employees and then he meets separately with partners and directors and every year I have seen our president carry some new message, some new concept all of which adds up to a continuing attempt to mold a growing and more mature approach to our responsibilities and a standard of ethics and standard of competence which keeps pace with the growth of the industry.

THE CHAIRMAN: Do I understnad the securities commissions encourage this? Do they think it is better

for this field of industry to be in the hands of the members who are active in it other than being subject to direct control by the state where everybody is on his own and some of them trying to get away with as much as they can?

MR. GASSARD: For some years now, Mr. Porter, we have kept close liaison with the various securities commissions and sometimes with the Attorneys General pointing out to them the importance of uniform legislation uniformly administered and I imagine that that will be one of Mr. Beatty's major themes this fall as he goes across the country. That keeps the commissions informed of our opinions and there is a sort of cross fertilization taking place that usually results in benefits to both sides. We are not waiting for the government to impose something on us: we are discussing and imposing views on them periodically.

COMMISSIONER LEMAN: Your paragraph 56 on page 44 implied that there were still a few areas where you were encountering trouble and that you felt there should be some improvement. What are the types of troubles you still run into and are not quite satisfied with?

MR. MILNER: There are unquestionably a lot of things we do not even know that have happened. We only see the ones that are brought to our attention in the main. But if you can go back to the image that it is in our own best interest to attempt to improve our own public relations and our public image to the fullest extent to have it brought out, we think we can

do a better job by doing that than by having governments do it the other way around.

For instance, what we are doing now is putting in a new by-law screening all our sales force completely. Every person who is registered as a salesman now with any one of our members or to be registered will have to get the approval of the local provincial committee before that salesman is allowed to go out and sell securities to the public. There will be a central registry between ourselves and the stock exchanges on all salesmen so that people who have got into trouble in, let us say, one of the stock houses, let out for unethical reasons, not necessarily criminal but unethical reasons, would have a very difficult time in getting a license in the Investment Dealers and vice versa.

It is all an attempt to upgrade the type of people that are in contact with the public.

MR. BEATTY: It involves ethics and competence.

THE CHAIRMAN: But the Investment Dealers' Association is recognized by this securities Act, is it not? The Investment Dealers' Association appears somewhere in the Act?

MR. GASSARD: In four provinces.

THE CHAIRMAN: It has certainly and undoubtedly the blessing of the authorities to that extent.

MR. GASSARD: We hope it will be all the provinces soon.

THE CHAIRMAN: Blessing is the right word.

COMMISSIONER LEMAN: You are talking of practices now about which the regulatory bodies can do nothing, is that it?

MR. BEATTY: That is right.

COMMISSIONER LEMAN: They might know about these things but because they are not criminal acts they cannot do anything about them?

MR. BEATTY: Principally ethics and competence.

COMMISSIONER LEMAN: Now that brings us to a question on which we have received various representations, and that is the type of securities regulation we have; statutory type. Primarily should there be a federal body or should there not be one? You have expressed the thought in paragraph 54 of Section E, and I think it is Recommendation No. 30, that there be not constituted in Canada what is called S.E.C type of legislation. I do not think it would be worth anybody's time here to

start discussing any constitutional issue that might be raised by that discussion, but we certainly can look at the practical aspect of it nevertheless. Constitutional issues can be solved by somebody other than ourselves. Can you tell us briefly what are the reasons you would be against an S.E.C. type of regulation?

MR. MILNER: I will ask Mr. Beatty to answer that question.

MR. BEATTY: Disregarding the constitutional problem which, incidentally, our council has grave doubts as to whether the Federal Government has any right in this regard, we have consulted the council of Investment Bankers' Association in the United States and our own council, and discussed the various areas that are served by the Securities Act of 1933 and the S.E.C. Act of 1934 in the United States. We could find no area that we have not existing regulatory bodies in Canada to serve what is looked after by these organizations, so that in our opinion the establishment of a federal body in Canada would be merely superimposing machinery on top of machinery that already exists.

We do not feel that it would complicate to a great extent the issuance of new securities, although it would be another nuisance and another expense. We feel that far more progress is being made and can be made through the existing bodies working with them, co-ordinating their activities, particularly the provinces, and by examining and improving the administration of the Companies Act.

Here we only have 10 provinces and the Securities Acts in these provinces are consistent and growing more consistent. Collaboration is excellent.

In the United States they have 50 States to deal with, some of which had no securities regulations whatsoever, so the problem was entirely different. In the United States they found it was necessary to form a national association of securities dealers in order to properly administer and regulate the operations of dealers of securities in the United States in spite of the existence of the S.E.C. In other words, the industry in the final analysis had to police itself and does have to today.

COMMISSIONER LEMAN: Well, the S.E.C. is not interested only in the industry as such, it is interested also in the issuers and the standards they must meet, so it is not just a question of the ethics of the profession.

MR. BEATTY: That is right, but they had some states with no regulations at all. We have no provinces without regulations, and these regulations are well administered and are becoming very similar to each other.

COMMISSIONER MACKINTOSH: What you say, Mr. Beatty, seems to be based on a confidence that our provincial administrations could be brought to a uniform degree of coverage and competence?

MR. BEATTY: Yes. There has been great advances in the last year and they are all conscientiously collaborating.

COMMISSIONER MacKEEN: While it might be admitted that you could increase your sales, Mr. Beatty, would a S.E.C. organization in Canada have more effect on non-members?

MR. BEATTY: We do not think so, Mr. MacKeen. We think the local bodies are far more competent than a federal body would be. The operations that the Securities Commissions desired to discourage require ---

COMMISSIONER MacKEEN: You have seen some examples in recent years of certain gentlemen moving from one province to another when they get caught up by the provincial commission in their own provinces. They move, for example, to Nova Scotia and New Brunswick and continue to operate.

MR. BEATTY: Well, it is true but it is hard to prevent a fellow from stealing if he is dishonest. All you can do is catch him after he has done the stealing. Not only do they move from one province to another, they move from one country to another.

COMMISSIONER MacKEEN: Would a federal body have more authority or catch up quicker with a man say who gets in wrong in Ontario and moves to New Brunswick? He operates there for quite a few months before he is caught up with.

MR. BEATTY: That is possible.

COMMISSIONER MacKEEN: Especially if he does not deal in that province of New Brunswick but deals across the border.

MR. BEATTY: This is possible, but then he will move to Lichtenstein or Panama and continue to

operate.

COMMISSIONER MACKINTOSH: Do you think we have a favourable or unfavourable balance of trade?

COMMISSIONER LEMAN: Just to see where this would lead us, we agreed that we would not deal with constitutional issues, but let us just assume for a moment that it would not be a superimposing agency over the 10 agencies existing already. Let us just assume that. We cannot prove it one way or another. What would be your thought as to the value or cost of getting a high standard of regulation and policing in the whole country as one method against the other?

MR. BEATTY: As I say, we covered this with the Investment Bankers' officials in some detail and we really could not see any advantage that they had over us as conditions exist today.

COMMISSIONER LEMAN: Well, now, let us look at the various fields where this applies. There is policing of the actions of the people of the profession, and there is policing of the actions of the issuers and, lastly, there are all the side issues like supervision over stock exchanges and stock trading, and that sort of thing. Let us take these one by one. If we look at the issuers, it is mainly a matter of the way prospectuses are used to sell securities. Is it your feeling that there is nothing to say in favour of our type of prospectus under the existing securities legislation which we have in Canada as against that in the United States?

MR. BEATTY: They have one advantage over us

in that they are able to issue preliminaryprospectuses in advance of the actual approval of the issue, and thus inform potential buyers of the qualities of the security which they are offering. On the other hand they have quite a few disadvantages, particularly in respect to the tremendous volume of material that is required. It actually defeats itself.

The S.E.C. only requires full disclosure, it does not regulate the quality of the offering. All it does is require you to disclose any shortcoming that there might be in the security, and by its very volume it defeats its own purpose. A full prospectus under the S.E.C. is such a voluminous affair that very few people plough through it. Consequently a disclosure in actual practice to the potential investor is not as full as ours, where our processes are simpler, consequently the volume of material is not as large.

COMMISSIONER LEMAN: Well, is it quite easy for the legislator to sit down and foresee every possible type of issue and say: You will have made full disclosure if you answer questions A to Z? Do you feel that that is a good full disclosure regulation?

MR. BEATTY: I think it is impossible.

COMMISSIONER LEMAN: Well then how do you overcome that in Canada?

MR. BEATTY: I do not think you can overcome it anywhere.

COMMISSIONER LEMAN: Well, is most of our security regulation and legislation now based also on the full disclosure principle?

MR. BEATTY: It is based on the whole disclosure principle. I believe the disclosure that is required now is adequate for any reasonable investment purpose.

COMMISSIONER LEMAN: Well, now, if this is full disclosure in the United States and in Canada, why does it take thousands of more words to make a full disclosure in the United States than in Canada?

MR. BEATTY: I think it is Parkinson's law.

THE CHAIRMAN: In the United States do they not itemize certain types of information that they want and include a series of questions that have to be answered?

MR. BEATTY: We have certain statutory information which our legislators deem to be necessary.

THE CHAIRMAN: They seem to have more and more.

MR. BEATTY: Yes, and more and more people process it.

COMMISSIONER BROWN: Is it possible that by having different authorities in Canada you get a certain amount of competition? Let us use Ontario, for example. If Ontario gets too strict so that it is virtually impossible for an issue to be made in Ontario they will be made in other provinces?

MR. BEATTY: It is possible.

COMMISSIONER BROWN: And this keeps things down to a reasonable level. If you ever get one authority will there be this danger of Parkinson's law developing; that is no one to criticize it or no others to compare it with, and it might get out of

hand?

MR. BEATTY: This is the point I am trying to make. It would grow and grow. I do not believe if we had a federal body that the provincial bodies would disappear.

THE CHAIRMAN: The history of securities regulations in Canada goes back to about the time of the great depression, I think, and it was somewhere around that time that there were a number of incidences that occurred resulting in securities commissions being set up, and since then they have gone through many other phases of approach to the whole subject. At first, as I recall it, they attempted to regulate in some detail as to what should be disclosed and what should not be disclosed, and what sort of spread should be allowed, and various other matters of that kind, and by experience over the years the viewpoint has changed materially until now it is largely a question of full disclosure. That is, reasonable disclosure without being tied down to specific details, depending upon the circumstances of the case. Is that not about it?

MR. BEATTY: That is right.

THE CHAIRMAN: There has also developed a considerable experience in regard to the enforcement of the statutes.

MR. BEATTY: It puts any regulatory body in an impossible position if they are asked to judge the quality of a security. For instance, mining stock; nobody can see what is under the ground. The Ontario

government for a while employed a geologist for the Securities Commission to try and upgrade the quality of the mining issues they were asked to approve, but it would be absolutely impossible for 100 geologists to visit every property that was registered, and even visiting them, to know whether there was anything under the ground or not.

COMMISSIONER LEMAN: The S.E.C. does not employ geologists, does it?

MR. BEATTY: No, but it demands more and more information of a technical sort such as is furnished by geologists, which disclosed no more than the Ontario geologists could disclose, but still must be part of the prospectus.

COMMISSIONER LEMAN: Let us not get carried away too much by the fact that people think that because the United States dollar is called a dollar and the Canadian dollar is called a dollar they should be at par. A lot of people think that way. We say S.E.C. type of legislation. We do not have to copy everything they have done or use exactly the standards they have used. We do not need to copy their regulations, we can just dovetail them to Canada's needs. I fail to see why you imply that Parkinson's law would operate more on a federal level than it does at the provincial level.

MR. BEATTY: One reason I have this view is that I do not believe the provinces would disband their securities commissions.

COMMISSIONER LEMAN: Well, we have assumed that.

MR. BEATTY: We are assuming that they are disbanded?

COMMISSIONER LEMAN: Yes.

MR. BEATTY: This would be ideal.

MR. MILNER: That is ideal.

THE CHAIRMAN: If you do not have any at all?

COMMISSIONER LEMAN: Am I to understand rightly that your opinion then is based on the fact that this bea superimposition over what exists, but it could be assumed that either through legislation and through agreements between the provinces and the federal government there would be one single agency, then you change your opinion?

MR. BEATTY: It would be perfect.

COMMISSIONER LEMAN: You think it might be more efficient to have one regulatory body?

MR. BEATTY: I would like to go back to the original discussion that we had which led us to believe thatour system is very good now in comparison with that in effect in the United States.

COMMISSIONER BROWN: I would like to explore this question a little bit further. You criticize a possible S.E.C. type in Canada because of the possibility of the development of, to use an expression, Parkinson's law?

MR. BEATTY: That is right.

COMMISSIONER BFOWN: If all provincial jurisdictions disappeared and were replaced by one federal jurisdiction ---

MR. BEATTY: This would be an improvement.

COMMISSIONER BROWN: You would not be afraid of Parkinson's law taking place then?

MR. MILNER: No, but Parkinson's law would apply at least in our opinion if we had a dual one to go through. It would be simply adding a further expense to all issuers. The costof registration in the United States is fantastically high.

COMMISSIONER BROWN: But they do not have a dual situation?

MR. BEATTY: Yes, they do.

MR. MILNER: I am speaking of the cost of the operation, I am not speaking of the cost of registrations. The cost in Canada would be similarly high in our view if we had to go through both a federal securities commission plus a provincial securities commission. What I understood Mr. Leman to say is that he is arguing on the basis that there would be only one securities commission.

MR. BEATTY: This would be ideal.

COMMISSIONER BROWN: This changes your whole idea?

MR. MILNER: It alters our veiwpoint completely if you are talking about only one securities commission.

MR. BEATTY: In the United States they do have state bodies as well as the federal one.

MR. SHAW: I think this is one area in which we might find one wide amenity within our acts. I am afraid that I cannot add here to the complete approval of a body. I am speaking entirely personally, if I

might say so and qualify what I say to that extent.

It would seem to me that one of the advantages of our present system is that the work to clear an issue is now divided among the varying jurisdictions. Even with that, because so many of the issues originate in Ontario and Quebec, one of our difficulties is getting clearances for issues in time to keep in tune with the market that then exists. I think the Ontario and Quebec Securities Commissions do an admirable job as it is, but I would hesitate to say without qualification that if all issues had to go through one agency, no matter where they originated in Canada, that we could expedite our issues and get them ready for the market as quickly as it is important for us to do, as we can do where the work is delegated and spread out through the provinces.

To that extent I think I would have to express some doubt that the one regulatory body in place of what we now have would meet with complete approval.

MR. BEATTY: You would be nervious that there would be an increased delay?

MR. SHAW: I would, indeed, and the delay factor could well introduce an expense factor which might be very important.

MR. MILNER: Could I ask if you would like to speak to that?

MR. SUTTON: Well, I am speaking directly on behalf of our own firm, and we would be in favour of one regulatory body; as Mr. Shaw says, there is this danger of delay, but it does take longer to get clearance on the S.C.C. in the United States than it does for us to get clearance here in Canada. Nevertheless, it is conceivable that you might run in to differences of opinion between different provincial regulatory bodies. This has not happened so far but it is something that we might be concerned about for the future. Our own feeling is that if we had one body it would be better, we would not want another body superintending them.

COMMISSIONER LEMAN: Might I ask one of the other large underwriting houses to speak on this?

MR. MILNER: Perhaps Mr. Strathy could speak to that.

MR. STRATHY: Mr. Leman, for the past few years when I was the chairman of the Toronto stock exchange I had a lot of dealings with the Ontario Securities Commission at that time and furthermore I attended a number of the conventions or conferences of the National Security administrators; they have an organization themselves, the various provincial security administrators and they meet once a year or more often, and they discuss these problems that arise between the various provinces and I have met with a great improvent in arriving at a similarity of

legislation or control of the various security dealers that come under their respective responsibilities. This is a thing which perhaps has not been established for many years because I believe that most of this is a post war thing, that there has been a gradual growing together of the work of the various provincial securities administrators to the benefit of the whole industry and to enable better understanding to prevail between the various groups that deal in securities and the various administrative bodies that control it from the provincial point of view.

COMMISSIONER MacKEEN: That all leads up to more uniformity?

MR. STRATHY: Yes. The requirement for a national securities administration. I am convinced that otherwise it would result in the development of Parkinson's law and the increased time to get the issue cleared and with the expenses that that would entail and the fact that certain areas might never come to market at all because the market conditions had changed in the interim. It is practical and it is becoming more practical and I have great hopes that this will be achieved in greater measure as the years go by.

THE CHAIRMAN: You visualize a central body sitting in Ottawa, no doubt, to which everybody would have to come to have their issues dealt with.

MR.STRATHY: No, I do not visualize that.

THE CHAIRMAN: When you say it takes more time that would be because it would be centralized?

[illegible]

MR. STRATHY: Everything would be funnelled through a central body; there would hardly be enough personnel to handle all the problems in all the new issues they are faced with, not only issues from the Investment Dealers' Association but they are a very broad ramification of the whole matter of new security issues in Canada; any mining stocks, and what have you.

Each province has problems but not quite similar with the other provinces, so that that particular province knows its particular problems much better and knows how to handle them than, say, another province. In Ottawa they would have to handle the whole broad scope of the industry, which is much wider than we are talking about here, the investment dealers.

COMMISSIONER LEMAN: There is the question of stating what the requirements are and also the matter of enforcing them, and in the area of enforcement it might be more frequent. However, let us pass on to the other aspect.

We talked about a problem in relation to acquiring issues and the matter of policing the industry itself and you expressed a clear preference for doing it yourself, and that can be understood, but there is the matter of stock trading. The S.C.C., as I understand it, has jurisdiction over stock exchanges too. Who has jurisdiction over stock exchanges in Canada?

MR. MILNER: The various provincial securities commissions.

COMMISSIONER LEMAN: I would think they do not in relation to the standards of performance of our stock exchange.

MR. BEATTY: They have used the self policing method.

COMMISSIONER LEMAN: How would the two standards compare, would you say, between the large national exchanges in the States and ours in Canada.

MR. BEATTY: They both seem to have had their difficulties. I would say that we have been just as effective as they have. The problem arises, again, in the technical nature of the business.

Where a case has come to court arising from irregular dealings through a stock exchange it has always proven extremely difficult to get a conviction. They have never, for instance, convicted anyone of a washed sale, which is contrary to the law of the land, but the industry in policing itself understands these matters where a jury would not, and it is possible to deal with it. Consequently your ultimate standard is going to be higher through using the self policing method than it is through using the legislative procedure.

COMMISSIONER LEMAN: Let us look at some of the problems where weaknesses appear to exist from your own suggestions here and let us take the point which you raise in paragraph 58 of Section E. You are referring there to a process called the "take-overs". Now, you suggest that this Commission should take an interest in this matter to see if shareholders could be better protected. What do you have in mind

specifically in suggesting that?

MR. MILNER: I will ask Mr. Shaw to speak to that.

MR. SHAW: Mr. Commissioner, this is, of course, a matter that has been very much in the public eye not only in Canada, but it is a matter of concern in Great Britain, and has been dealt with in the recent reports.

The objections to the take-over operations, the so-called take-over bids that have occurred in the recent few months have been related to basically three factors. One, that the buyer has not disclosed himself. The board of directors of the company involved is in no position to advise the shareholders as to the competence or desirability from the shareholders' point of view of the new ownership or there has not been disclosure of the prospective buyer. There has been a limit on the amount of shares that the prospective buyer has indicated a willingness to buy and an indication of some haste, if you wish, or desire to get the thing wrapped up and out of the way quickly, so these bids have had the qualification that they will leave the offer open until a given date or until a given number of shares have been presented at the price offered.

The objection there is that if the offer would appear to be so attractive that the shareholders want to rush in and deposit their shares immediately, that those who are nearby get theirs in first, and those who are some distance away or for one reason or

another are unable to get them deposited, are out, so that brings up the third difficulty that the offer is not open long enough.

A suggested manner of dealing with this is one which would deal with each of these things separately; first of all there should be a full disclosure of the prospective buyer; if there are more shares deposited than the buyer is willing to buy, that the offer then should be made operative on a proportionate basis, and if there are 100,000 shares wanted and 200,000 shares presented, or 200,000 shares outstanding, that 50 per cent of those present holdings would be taken over. Also, in any event, that the thing should be left open for a sufficient length of time to permit people under normal circumstances to get to their boxes and the services to be physically applied.

COMMISSIONER LEMAN: That all sounds quite reasonable, Mr. Shaw, but who should impose this code of procedure?

MR. SHAW: Let me say that these are the suggestions that are put forward, and there is some question as to whether everyone involved or everyone within our industry would say that these suggestions in themselves are sufficient.

First of all for the reasons you suggest, who would impose the policing, and if they are listed shares, the inference seems to be that the stock exchange would say that if it is a listed share

that that is what must be done or the listing privileges would be jeopardized.

It was suggested that there may be other circumstances which should be taken into account. What happens, for instance, in the event of a large holding company, if you wish, becoming interested in a company and watching its progress over a period of months or even years and gradually accumulating these shares and saying that here is a situation which we may want to be in a major holding position. They end up, if they are seeking operative control, they wind up at some stage where they need X number of shares -- it may be 50,000 shares or it may be more or less -- and at that stage they then say,"Well, we are going to wrap this thing up; we want 35 per cent or 51 per cent" -- or whatever percentage they feel they need and they go over the shareholders' list and they pick on eight or ten large shareholders and they go to them and they say that they will make a bid for all of their non-par shares at a price which must be made attractive to attract their attention, and they go to only those six or eight shareholders. What happens is that ---

COMMISSIONER LEMAN: I do not want to interrupt you, but our time is passing by and my point is this; I do not think we should go into the details here as -- the details of what would be the right procedure, but the thing is who should decide the way it should be done, which is the proper, fair and honest way of doing it. Who should decide that and who should

impose it?

MR. SHAW: I am assuming that we -- I think I am right in this; we have made no specific recommendations in this respect.

COMMISSIONER LEMAN: But you feel that there should be some kind of regulation for this sort of process to take place?

MR. SHAW: I may have misunderstood your question; I thought we were dealing with the reasons why we feel we are in a position to make this recommendation. I do not think that -- personally I have not the answer.

COMMISSIONER LEMAN: But have you no idea of what would be the proper agency to deal with a problem of this kind?

MR. SHAW: The obvious ones, obviously, would be -- if there are shares of stock -- the stock exchange is involved.

COMMISSIONER BROWN: Would it logically be the stock exchange, because if you did wish to have a stock listed, this might be just what the would be take-overer wants.

MR. SHAW: I would be glad to toss this ball to somebody else.

MR. ELY: I have a view on that. I do not think it is the stock exchange so much, and I have not discussed it with anyone in our industry, but there must be a way through the company or something which makes it impossible for a non-disclosed buyer to take over. In other words, it could be through

the Companies Act that no take-over bid can take place unless the people taking over are disclosed. Once that happens can the onus not be put on the company to deal with that person on the basis of pro rata; no take-over or take-over. How could it still be if there are instructions to the contrary?

COMMISSIONER LEMAN: That is raising another nice legal problem; the Companies Act does not deal with the form of securities trading.

MR. ELY: I do not know what the reason is.

COMMISSIONER LEMAN: What control does the company have? Even the board of directors do not know who these people are.

MR. SHAW: There was a recently publicized incident where the security commissioners for Ontario said flatly, "It is not within my province, it is up to some other body" and inferred that it was the stock exchange, and I believe it inferred it was our responsibility. I think I am correct in saying that up to the moment we do not know the answer in the Association just where this responsibility should lie.

COMMISSIONER LEMAN: Let us resort to our big brother below the border; how is it handled down there, who handles this sort of a problem?

MR. MILNER: In the United States they have the same difficulty in small companies; they have no difficulty with companies listed on the New York Stock

Exchange, their rules are adamant.

COMMISSIONER LEMAN: It is the stock exchange rules?

MR. MILNER: Yes.

MR. COX: I think that only covers a few of them, the major ones.

MR. BEATTY: It is a very difficult problem and one which we have not ignored; we have discussed it at great length, but the only recommendation which we can come up with that we feel is constructive and workable is this one of disclosure. The technicalities which are in the best interests of the purchaser and the vendor are so complex that it seems impossible to work out a pro rata arrangement or a "first come first served" arrangement that serves everything that is being sought in a take-over.

COMMISSIONER BROWN: I suppose there could be some penalty under the Companies Act if they were dealing in their shares in that way?

THE CHAIRMAN: It is a matter of legis-lation.

MR. BEATTY: An appropriate body, yes.

COMMISSIONER MacKEEN: You can have many of these Companies Acts to deal with.

MR. LEMAN: How about forbidding trustees from acting?

MR. BEATTY: It could be by self policing bodies.

COMMISSIONER BROWN: It is a Companies Act

problem and not the Securities Act.

MR. MILNER: In our recommendations and suggestions this falls under this group where we say we do not know the solution; it is a complete matter of law as to whether it should be put into the Federal statutes or the provincial statutes, but we are not lawyers and we do not know what the answer is, but we do say that here is something that there should be definite steps taken to improve the present situation, which is not a good situation for this country or any other country, but quite frankly we do not know how it should be approached and we are putting it to the Commission, and saying that here is something which we think must have your consideration as to how it should be done; we leave it to you to do that part of it. If you wanted us to say we will appear back in October or November and wanted us to consult with the legal profession, that type of thing, you are on a different basis.

COMMISSIONER BROWN: In the same context, would you care to discuss whether this question of continuing information about the corporation's affairs to their shareholders. This again is a legal problem as to who is to say that this must be done. This probably falls more into the province of the stock exchange and it also falls into the Investment Dealers' Association with respect to companies that issue debentures and bonds but whose common shares are not held publicly and the only information given out at the time of the new issue.

MR. MILNER: Well, the best example that you could use for what might be called, I don't say "perfect" but very workable legislation is , that the New York Stock Exchange has not only full disclosure at the time of an issue, but they force full disclosure in perpetuity. There must be full disclosure of the various facets of the company, but that only applies to the one stock exchange. Here we have got three main stock exchanges: Toronto,Montreal and Vancouver, and we also have nine provincial securities commissions, and it seemed to us there must be some way of tying in the securities commissions plus the stock exchanges to having perpetual full disclosure. I think, as Mr. Brown quite rightly says, you run into it on a bond issue of a company that has no common shares, and a person does not know until the day he dies what the company has done.

COMMISSIONER BROWN: Could the underwriter have an agreement with the trustee this information will be supplied?

MR. BEATTY: This is frequently the case -- usually the case.

COMMISSIONER BROWN: This arises quite frequently on debenture issues of subsidiary companies?

MR. MILNER: On the question of disclosure, it is very hard to force people to disclose who don't want to disclose. You may quite rightly say, "Don't underwrite an issue" -- that would be your answer. If the people are not willing to disclose, you should not sell the security, but unfortunately some-

one always will sell a security if you don't -- if it is a good security. I think you have got a perfect example in the T. Eaton Company. There is a company every person believes is a very well run industrial company, but no one knows if it is or not. No one has ever seen their balance sheet.

THE CHAIRMAN: They don't publish their statements -- just the way you don't.

COMMISSIONER LEMAN: Everybody thinks most of you are well run, but nobody knows either.

Well, the Security Analysts Society in Toronto made that same request, that the commission consider this matter of disclosure and good standards of financial statement publication etc., and we didn't get to any conclusion with them. We asked them if the Investment Dealers as a group could obtain this of companies before they agreed to handle their securities and they said, "Perhaps if there could be unanimity among the group we probably could, and with the co-operation of the stock exchanges we probably could obtain it", but they didn't seem to think the association was quite ready to take the necessary steps to obtain it. That led us into asking them, if the private sector won't do it, perhaps an S.E.C. type of legislation would do it, and they were not in favour of that. So, we are just trying to get a little help from you as to which are the best ways of obtaining these things which everybody seems to think are desirable.

MR. STRATHY: Surely, it must be through forces of legislation in the final analysis, and it

applies to all companies whether they are companies that are financed through the I.D.A.or stock exchanges or any other organizations. It surely applies to all public companies. Therefore, public companies are either with provincial charters or federal charters, so it has to be a federal enactment and a provincial enactment.

COMMISSIONER LEMAN: Well, let us go on to the next problem concerned with this whole area, which is your recommendation -- you seem to have some misgivings about some trends related to mutual funds. Recommendation 31, for instance, suggests that perhaps there is need for regulation of mutual funds. What are the problems there? What do you have in mind?

MR. FOWLER: To some extent I speak for myself because it is not a subject which has been discussed too much amongst the members, but basically I feel that regulatory legislation should be introduced. Presumably it would have to be at provincial levels under the present setup, which pertains to the mutual funds themselves.

The first thing is that legislation should be at least uniform in its concept and administration in all provinces. At the present time as far as the mutual funds are concerned, as far as I know, there are no actual regulations pertaining to investments. I think a great deal has got to be said about all the major funds, that they have entirely voluntarily set their own standards which are very high, and they rather conform with the standards which the S.E.C. lays down

for mutual funds in the States.

There should be legislation on limitation of investments; that is, mutual funds should not be allowed to own, we will say, a controlling interest in any particular company if it is going to function in a true sense as a mutual fund.

There should be restriction against practices such as selling short or buying on margin which are, again, contrary, to my mind, to the public trust, shall we say, in mutual funds.

There should be also legislation which ensures arms length dealing and which would avoid any conflict of interest between management and the shareholders.

There should also be a maintenance of appropriate and uniform standards of advertising and sales literature. There is a great spread on that at the present time. I think again we have got to say the major mutual funds have done an excellent job, but there are some smaller ones where, to my mind, a lot of their literature could be misinterpreted if you were not a reasonably sophisticated investor.

The other one is that I think all mutual funds should be required to have a clear statement of the policy of the company. This is to prevent mutual funds from using the name"mutual fund" as a cloak to carry on other perfectly legitimate investment business.

I think those, Mr. Chairman, cover the main points that I have in mind. The thing is at the present time there is no legislation that I know of pertaining particularly to mutual funds. There is one

that comes under the Income Tax Act, in Section 69, whereby a company cannot derive more than 10 per cent of its income from one corporation. That is about the only regulation there is in existence, as far as I know.

COMMISSIONER LEMAN: But mutual funds are sold in Canada partly through members of the Association and partly outside the members?

MR. FOWLER: More funds are selected by -- they usually call it the underwriters of the actual mutual fund; the "sponsors" may be a better word. There are more shares of mutual funds sold by them than by the Investment Dealers.

COMMISSIONER LEMAN: Their salesmen, when they sell direct, have to be licensed salesmen?

MR. FOWLER: They have to be a licensed salesman, but as far as I know there is no specific standard that the salesman has to attain. Frankly, I think I am walking into ground that is away from the investment dealer and into their field a little when I make that statement, but I do know of many instances where the man has had maybe two or three days training with the sales organization and then he is out selling mutual shares.

COMMISSIONER LEMAN: If they are licensed salesmen, this whole realm of regulation you are talking about would come under the jurisdiction of the provincial securities act, wouldn't it?

MR. FOWLER: Yes sir, as far as being a salesman is concerned, but as far as the fund itself is concerned there are no regulations. They have to comply with the

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[illegible]

[illegible]

[illegible]

[illegible]

various provincial regulations in regard to the issue of a prospectus. They have to provide the necessary statutory prospectus and that sort of thing, but there is no regulation I know of either on a federal level or provincial level which specifies in the manner that is dictated by the S.E.C. as to the mutual funds investments -- that they cannot purchase more than a certain percentage of a certain company or that they cannot sell short.

I would like again to emphasize the fund themselves on a purely voluntary basis, I think, have been very, very careful in setting up a very high standard, but that does not mean that without the necessary regulation it will continue.

COMMISSIONER GIBSON: Would you restrict the investment powers to any further degree? You said: Not more than 10 per cent; make sure transactions are at arms length; no selling short or buying on margin?

MR. FOWLER: I haven't really worked out any particular thing, but I definitely would be against buying on margin, selling short and things of that nature.

COMMISSIONER GIBSON: How about the kind of asset they are allowed to purchase? Any restrictions on that?

MR. FOWLER: No, I don't think we should do that because providing the fund reveals -- and again, they publish quarterly reports of the securities they hold, and the owner of the shares knows very regularly what has happened, and that is one of the advantages,

at least one of the things why the public have gone for the mutual fund in the way they have, that they like the attitude of the management operating in a goldfish bowl at all times.

COMMISSIONER LEMAN: You are looking to the future mostly in your recommendation? You are not too worried about the present situation?

MR. FOWLER: No, I think at present we have got to give the fund very high marks.

COMMISSIONER LEMAN: Lastly, and still in this general area, there is a question I would like to ask you: What, in your view, should be the relationship between stocks exchanges in a country? Is there an area where they can compete, and what is that area?

MR. MILNER: I am sorry I didn't quite get your question.

COMMISSIONER LEMAN: What generally should be the relationship between stock exchanges in a country? Are there areas where they can compete and where it is useful that they compete, and what are these areas?

MR. CRETZIANU: Well, I would not speak of competition between stock exchanges, but I certainly think that the arbitrage transactions which can be done between the markets can help in the better pricing and distribution of securities. Certainly, the fact also that a stock exchange such as, say, San Franciso is able to operate for two or three hours later than the New York Stock Exchange is also helpful to the better distribution and pricing of securities.

COMMISSIONER MACKINTOSH: Are there any limitations on arbitrage operations among Canadian exchanges?

MR. CRETZIANU: I am not too sure of that now. I haven't followed it recently. There have been certain changes.

MR. STRATHY: There is not really a great deal of arbitrage, so-called arbitrage, taking place in the securities listed on stock exchanges in Canada, because in a great many cases you will find a member of a stock exchange is a member of more than one stock exchange. So, in part, that satisfies the requirement of achieving the best market for the buyer or the seller of the stock.

COMMISSIONER MACKINTOSH: He puts the order in the exchange ---

MR. CRETZIANU: He puts the order on the exchange where the best fill can be obtained, or, if it is a bigger amount of shares he splits it amongst various stock exchanges. There is arbitrage but it has been, I would say, dying to quite an extent, but it does have this effect in levelling the markets between the various stock exchanges. In actual practice the arbitrage is confined to industrial stocks between Toronto and Montreal and very little more than that. There is no arbitrage to speak of in minor stocks.

COMMISSIONER MACKINTOSH: You say it is dying: You mean because there is not sufficient spread to make a living on it?

MR. STRATHY: That is right and because the

stock exchanges have firms members of more than one stock exchange.

COMMISSIONER MACKINTOSH: There is no restriction on fishing, but there are no fish?

MR. STRATHY: There are less fish.

COMMISSIONER LEMAN: Would there be any arguments in favour or against just having one stock exchange with branches as against having numerous stock exchanges?

MR. STRATHY: Well, I would say that the object of the stock exchange is to provide a marketplace so in the United States in the main the prime stocks are listed on the New York Stock Exchange. That does not mean that certain of those stocks are not listed on the midwest or Pacific coast exchanges but the prime market is the New York Stock Exchange. Those that do not achieve that prime degree of respectability or what have you or record of earnings are listed on the subsidiary stock exchange, the American stock exchange. That does not apply so much in Canada because in Canada there are really two major exchanges, the Montreal and Toronto stock exchanges. There are a great many similar listings on both exchanges. There is the Vancouver stock exchange which might be deemed a prime stock exchange but it is much smaller and on that stock exchange also are listed many of the stocks that are listed on the Toronto and Montreal.

Now, really a broader market could be achieved if there was one stock exchange if you were not looking at the other factors that come into the picture. It might be said that you would achieve the best results by having a number of stock exchanges each having different listing qualifications so that the very large companies with a long record of earnings and sound management could be on the prime stock exchange like New York, the secondary group might be on another stock exchange like the American et cetera, but we have built up a system which has more or less happened which is different than the United States and it fulfills its function

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reasonably well, I would say. But it only applies to listed stocks and that is only a small proportion of the public companies with shares in the hands of the public.

THE CHAIRMAN: Adjourn for ten minutes.

(At this point a short recess was taken.)

THE CHAIRMAN: We shall now resume.

COMMISSIONER LEMAN: Mr. Milner, before the recess I asked a question -- perhaps I did not put it quite clearly but I did not get an answer to it and the question was: Are there areas where exchanges can compete with each other. There seemed to be a reply that there was no such thing as competition between stock exchanges. Is there anything stock exchanges can do to encourage listing on them and to encourage trading on their particular exchange as against other exchanges, or is there no such process of competition going on?

MR. MILNER: No, stock exchanges can compete for listingsto the detriment of the securities to the extent that one stock exchange might waive clause 3 (c) on the listing of proper disclosure and if the company so desires or did not want to give the information they might list on that stock exchange and not have to give the information. It would be far better if the stock exchanges had identical restrictions as to listing.

COMMISSIONER LEMAN: So that any area in which stock exchanges may compete with each other would

not produce any particular good to the securities industry; on the contrary it would be the other way around, is that right?

MR. MILNER: Well, the competition, I think, is proper competition, the competition of attempting to build up bigger businesses. Probably more business would be done in two big stock exchanges rather than one. That competition is good. Of course, a national exchange would have the same effect in the long run, but the fact is people want to deal in their own stock exchanges, that is, the people in Quebec all prefer to deal on the Montreal stock exchange and the people in Ontario, I fancy, are more anxious to deal on the stock exchange, on the Toronto stock exchange, and if you go out west you have the same thing in Vancouver where your Vancouver people prefer to deal on their own exchange.

COMMISSIONER BROWN: There is one factor that does affect this and on which I think we would like to have some comments and that is provincial transfer taxes.

MR. MILNER: Well, of course, we are against provincial transfer taxes.

COMMISSIONER BROWN: That is the answer I expected.

THE CHAIRMAN: I have heard this for many years.

COMMISSIONER BROWN: But it does affect the mobility of capital in Canada?

MR. MILNER: It affects the mobility of capital in Canada and also the succession duties have the same effect. That is the reason that you get so many transfer agents. Some of the larger companies have transfer agents in three or four provinces merely to get around that.

COMMISSIONER BROWN: Some of the largest ones have not?

MR. MILNER: No, some of them have not.

COMMISSIONER LEMAN: Well, the stock exchanges will come before us and they will be able to defend themselves, Mr. Milner. We wanted your opinion on some of these points. That is all I have in that area.

MR. MILNER: Mr.Leman, you asked one question before lunch and I said we would endeavour to answer it this afternoon. I am going to ask Mr. Cretzianu to answer it.

MR. CRETZIANU: I have made a quick estimate of these pooled funds and I find that life insurance companies in Canada at the end of 1959 had assets of $7,500,000,000 while in the United States their assets were $125 billion. So it is quite clear, if you want to take the population ratio, that these funds are much higher in the States.

Trustee pension funds, I made an estimate of around $3 billion against $33 billion so there it would be a little closer.

Investment funds -- in 1960 in Canada were nearly $750 million net worth of assets and in

the United States they were $20 billion, so there again it is quite clear that the proportion in the United States is much higher.

MR. MILNER: Does that answer your question, Mr. Leman?

COMMISSIONER LEMAN: Yes it does, thank you.

COMMISSIONER MACKINTOSH: Mr. Chairman, I have a few questions I would like to ask in clarification of some parts of the submission. In Appendix D on municipal finances in paragraphs 12 to 15 there is an explanation of the need to have some systematic municipal statistics. Has the Association asked for these statistics from the various departments of municipal affairs and been unable to obtain them?

MR. MILNER: Mr. Johnson, would you care to speak on that?

MR. JOHNSON: I know of two instances where the provincial governments have been asked to improve on the information that has been provided. We are provided with some information. It is usually late in reaching us. The main complaint in one province is that you get the information the day of the tender or the day after whereas we require it about two weeks in advance. The information that is provided in this instance is quite complete.

COMMISSIONER MACKINTOSH: Would it be impossible to get the provinces, in the interests of helping the municipalities with their financing, to

provide that they have to submit this information? You have a form here of which part is statistical. Why is not the sensible thing to have them submit that when they ask for tenders? It was suggested earlier that after a firm had got a tender that they had to go back and ask the municipality what the facts were about it. It seemed an awkward piece of business. Why not have it required that if they are going to put out bonds for tender they have to supply the information?

MR. JOHNSON: Unfortunately the Association cannot dictate the requirements, but the I think the Association should put some pressure on various provincial governments to provide the information in good time.

COMMISSIONER MACKINTOSH: Well, of course, there is the extreme course of a member of the Association not being able to tender. I know a lot of contractors who will not tender unless the architect's specifications and drawings are satisfactory. Part of that, I think it is Exhibit A is, of course, qualitative and that would have to be, I imagine, supplied by the dealer himself if you are going to have a rating on the facilities of the municipal council and the political climate. I do not think that you can get any official verdict on that.

MR. JOHNSON: No, we would not expect that, sir.

COMMISSIONER MACKINTOSH: But with the rest of the form I think it could be made a condition in

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asking for tenders.

MR. MILNER: The difficulty, Dr. Mackintosh, of course, in the small rural municipalities where they have got inefficient local clerks of the council, in the farm areas where a farmer acts as municipal clerk and it is haying time and he does not answer the inquiry. But there has been a vast improvement in the municipal statistics over the last three years, that is, the provinces in the municipal departments have helped us considerably in getting statistical information together. They have made it very awkward for municipalities to get grants unless they submit proper balance sheets and that is the quickest way of getting the information.

COMMISSIONER MACKINTOSH: You have a number of recommendations concerning municipal securities. One which occurs somewhere in the body of the submission is the suggestion of provincial assistance in taking up issues and the various forms which it might take. You suggest some grants might be earmarked for the service of the debentures. Are you referring there to special grants or to any grant that is due to the municipality from the provincial government?

MR. MILNER: Well, Mr. Johnson will say what they do in Quebec there.

MR. JOHNSON: We refer there to special grants and this is generally in the case of grants made to school commissions where there is a grant for, we will say, $200,000 which is to be payable over a five-

year period at $40,000 a year, and that grant is specially earmarked for the servicing of the debt during the years in which the grant is received. Consequently, the first five maturities in the serial issue are increased by the amount of the grant and that enables us to sell those particular securities at very close to the rate that would be received on direct guarantee of the province, and, consequently, the school commission not only benefits from the receipt of the grant, but benefits from the slightly improved cost of borrowing.

COMMISSIONER MACKINTOSH: This, in your reckoning is a good thing?

MR. JOHNSON: Yes it is.

COMMISSIONER MACKINTOSH: What about the practice in some provinces of using provincial funds to purchase part of the issue which I gather helps both the municipality and the underwriter?

MR. JOHNSON: That is very helpful but it does not enable the borrower to obtain quite as attractive a rate because the investor does not take that into consideration when making his investment. He is not buying something with a type of provincial guarantee on it.

COMMISSIONER MACKINTOSH: He may not actually know whether it is so or the degree to which it is so?

MR. JOHNSON: That is right, and as far as the investors are concerned the security is no better than if there was no agreement between the government and the underwriters to purchase part of

the issues whereas if you have a grant the borrower knows a certain part of the debt is going to be paid off.

COMMISSIONER BROWN: If this is known before the tender it encourages underwriters?

MR. JOHNSON: Where they might be concerned about market conditions they are inclined to take a little more risk than without that assistance.

COMMISSIONER BROWN: And would it not at other times have the effect that if it was a very competitive tender there is a tendency to work on a narrower margin?

MR. JOHNSON: That is right.

COMMISSIONER MACKINTOSH: What about provincial guarantees which I think you speak approvingly of although you do not actually recommend them?

MR. JOHNSON: We do not recommend them but from the point of view of borrowing cost it does definitely reduce the cost of borrowing to the municipality but it also has the effect at times of encouraging the municipalities to go out and spend money more freely than they should.

COMMISSIONER MACKINTOSH: Yes, I do not suppose any province is likely to offer an open guarantee. They would keep some control.

MR. JOHNSON: We have seen instances where issues have carried an unconditional guarantee of the province and the money has just disappeared; it was

not properly administered.

COMMISSIONER MACKINTOSH: No province extends beyond particular categories of municipalities?

MR.JOHNSON: It would be under very special circumstances where the money probably could not be raised otherwise in the volume required.

COMMISSIONER MACKINTOSH: What importance do you attach to your recommendation that insurance companies be allowed under the Insurance Act to carry these securities at amortized book value?

MR. JOHNSON: I cannot give you a guess at the percentage that the insurance companies might increase their investment, but this is a problem that we run into from time to time where insurance companies have used that possibility as an out.

COMMISSIONER MACKINTOSH: As an argument for not buying?

MR. JOHNSON: That is right.

COMMISSIONER BROWN: The insurance companies came up with a similar recommendation but it was not unanimous. It was the expression of opinion of some that this prevented trading.

MR. JOHNSON: I think that some insurance companies would increase their percentage investment in municipals if they were permitted to amortize. This has the effect of freezing them in certain instances.

COMMISSIONER BROWN: Could this be offset by the inability it would place on the insurance companies to place out municipal issues?

MR. JOHNSON: I would not be prepared to say

that it would offset it fully, but it would certainly be of assistance in times of low market values where, if they would be able to amortize, they would be closer to the market level than they are at present.

COMMISSIONER BROWN: There is some argument about restricting the amortization categories to those that are obviously going to be met at maturity; in other words, the obvious ones are Canadas where the power of issuing the currency is in the hands of the borrower and a slight extension of this would go into the provinces, but how far are you extending this when you get down to municipals?

MR. JOHNSON: I think it would be very difficult to divide the municipalities up into those where the securities should be amortized and those where they should not be.

MR. MILNER: Well, Mr. Brown, the municipal debt is probably in the last analysis the best debt there is in the country if it is under proper control. The willingness to pay of the small municipality is unlimited. That is why we are loathe to have provincial guarantees and that sort of thing to encourage a higher ratio of debt than the municipality can properly carry. But since the revision of the Municipal Acts after the 1929-31 period there have been practically no municipal defaults, in fact I do not know of any municipal defaults in the last ten years.

COMMISSIONER BROWN: One of the changes that came about because of those problems was that I think

all municipal acts now require other than those municipalities that are specially incorporated to issue only serial or instalment bonds and not sinking fund. Would you like to comment on this? Has this got an effect on the present market?

MR.MILNER: I think I will ask Mr. Johnson to answer that.

MR. JOHNSON: I do not think I got your question.

COMMISSIONER BROWN: Do you think that the market for municipal bonds would be improved or worsened if municipalities were to go back to a sinking fund type of issue rather than a serial type of issue?

MR. JOHNSON: You are talking about the secondary market now or the primary market?

COMMISSIONER BROWN: Primary market.

MR. JOHNSON: I think the fact that there would be some secondary market created by sinking fund operations would improve distribution.

COMMISSIONER MACKINTOSH: What is your view of the suggestion we have had that they be allowed to issue debentures which in the early years would be of serials, and there would be a sinking fund for the longer term?

MR. JOHNSON: That is the suggestion in this brief.

COMMISSIONER MACKINTOSH: Oh, I see.

MR. JOHNSON: That is in this brief.

COMMISSIONER MACKINTOSH: I must have forgotten what play we were producing.

MR. JOHNSON: You probably have two categories of investors who buy municipals. You have short-term buyers who like to buy one to five, or sometime one to ten year serials, and your life companies and pension funds have long-term investors who prefer a definite one term, and we believe they prefer 15 or 20 years sinking fund debentures rather than 11 to 15 years serials.

COMMISSIONER BROWN: Would you like to see the municipalities in Canada permitted to issue the type of mortgage loans that the specific corporations in the United Kingdom are permitted to issue?

MR. JOHNSTON: I am afraid I cannot answer that because I do not know what they issue in England.

MR. MILNER: You mean redeemable ones?

COMMISSIONER BROWN: They issue redeemable loans to individuals, and I think they are redeemable in three months. If someone has £50,000 to put to work they get in touch with their local corporation and arrange

to deposit it, and they get a piece of paper on which they get the current interest rate which at the moment is 6½ per cent.

MR. JOHNSON: In other words it is short-term?

COMMISSIONER BROWN: Yes, redeemable on three months notice, and they are fully registered.

MR. JOHNSON: I would not favour that.

COMMISSIONER BROWN: I did not think you would.

MR. JOHNSON: There is nothing selfish about it, I was thinking of the municipalities.

COMMISSIONER BROWN: Do they get nothing out of it?

THE CHAIRMAN: The initial debentures being as good as you say they are, why is the differential in interest rates so great?

MR. MILNER: Marketability is probably the main factor, Your Honour. People who invest in municipal debentures want a higher yield than they do have in market debentures, whether it be one-quarter of one per cent yield or one-half, I do not know. If you are comparing Ontario as against a provincial issue, a good municipal sells within one-quarter of one per cent of the yield of the profits.

COMMISSIONER BROWN: Yes, but it is the type of municipality that you described; the small municipality which you put very high as being credit worthy. Is it because the public do not realize that it is as credit worthy as it really is? They are the ones who can less afford to pay the high rate of interest.

MR. MILNER: Not necessarily. I would not think that would be a true statement. A small municipality has just as good taxing power as the large one.

COMMISSIONER BROWN: Yes, but it has not got the big industry. They work on a much smaller scale and do not spend the amounts of money that the others do. They do not spend as much as the bigger ones do, nor in the same proportion. Is it because their credit worthiness has not been sold to the public?

COMMISSIONER MACKINTOSH: Mr. Milner, as you said, first marketability and secondly, lack of knowledge on the part of the investing public, is that true?

MR. MILNER: The lack of knowledge to some degree, but actually it is the marketability which accounts for the higher yield which attracts the insurance company and the pension funds to buy municipal bonds.

THE CHAIRMAN: Yes, but the marketability depends to some extent upon the knowledge of the public as to the value of the securities.

MR. MILNER: I would not think -- I do not think that is nearly as much of a factor. If you start dealing in the far northern securities where you are dealing, for instance, in mining areas, there is a risk element there.

THE CHAIRMAN: I am talking about the ones that you say are first-rate. I assume that is what you meant, that they are first-rate as far as credit risk is concerned yet they are about third-rate in line

with interest rates.

MR. MILNER: There again you have got a somewhat similar situation as was brought up this morning in respect to provincial issues. Your provincial issues do not sell in the same level of price. Buyers dictate the price, we cannot dictate it.

THE CHAIRMAN: I understand that.

COMMISSIONER MACKINTOSH: If I can go back to this question of amortized book values for these municipal securities, I should like a little further information in this regard.

Is it not a fact that for quite a number of small municipal issues, a realistic market price cannot be produced but can only be inferred?

MR. BEATTY: It is a great nuisance to investors with large portfolios to have to value a large number of individual items.

COMMISSIONER MACKINTOSH: May they not have a debenture of small municipals with the most recent sale that can be found being several months ago?

MR. BEATTY: They sit down and value them all in collaboration with the dealers each year and try to get a standard valuation for the use of the insurance industry as a whole.

COMMISSIONER MACKINTOSH: Thus you only infer values?

MR. BEATTY: You only infer values.

COMMISSIONER MACKINTOSH: If some other security is selling for this, then this one ought to sell for that?

MR. HUNTER: There is a market for all these securities if these accounts want to sell them on the secondary market. There is no active market for them but they can put a price on their securities and the dealers will go to work and sell them for them. There is a reasonable amount of volume for that.

MR. JOHNSON: Dealers will buy them for position also. There is no quoted market on them as you have in Canada where you have a bid side and an offer side. There is a bid side always and occasionally an offer side if there are any bonds available.

COMMISSIONER GIBSON: This has the effect of locking municipal security holdings and it is more tightly into insurance companies portfolios. Would you like to see that happen, or where is the trade in municipal securitdes?

MR. JOHNSON: We would like to see more tradings in them.

COMMISSIONER GIBSON: This is what is worrying me. You want to allow insurance companies to value these securities at the amortized book value, and yet some of the insurance companies do not like this idea because they would not feel like trading in them to the same degree. There is a bit of a conflict here, I think.

MR. MILNER: The trade, Mr. Gibson, in the insurance companies in the secondary market on municipals is not much at any time and, frankly, I do not see what [illegible] difference [illegible] the amortized value would have. In other words if a municipality two or three

years ago sold a security to yield 5 per cent to one of the insurance companies, it is obvious that it will take a wacking loss on today's market. Conversely, if securities sold today to the insurance company from a municipality, two or three years from now they could easily dispose of this at a profit.

COMMISSIONER BROWN: Is this a guarantee?

MR. MILNER: Without guarantee.

COMMISSIONER BROWN: I mean, to sell them at a profit? Can we quote you?

MR. HUNTER: I would like to point out again that in 1961 primary sales of municipal securities were approximately $462 million, and yet there were $368 millions of secondary market sales, so there is a market for them.

COMMISSIONER BROWN: This is the point that Mr. Gibson and I were making. Anything that tends to lcok this market up is going to restrict this trading.

COMMISSIONER GIBSON: On the whole it is definitely felt that if they carried them on their books at the amortized value rather than the market or book, whichever is the lower, they are much less likely to sell them at a loss.

COMMISSIONER MACKINTOSH: If I can go back to another recommendation, I should like to hear some comment about it. I refer to Appendix B, provincial financing, you recomend that the use of savings loans type of issues be sharply curtailed.

MR. MILNER: Mr. Ely, would you like to speak in that regard?

MR. ELY: I do not think it needs much comment. I pointed out that savings loans are in effect a blank cheque on the lender. Provinces do not control currency and can find themselves in a very embarrassing situation.

COMMISSIONER MACKINTOSH: A blank cheque on the borrower?

MR. ELY: I am sorry, a blank cheque on the borrower, yes, if that borrower has not got control of currency he is asking for trouble, and we have seen some of it.

COMMISSIONER MACKINTOSH: Does the danger arise from the existence of such loans or from the excessive use of them?

MR. ELY: The excessive use.

COMMISSIONER MACKINTOSH: There is a small stable market for that sort of thing in particular localities, is there?

MR. ELY: The danger really arises, Dr. Mackintosh, from excessive use, and they should be, I think the words are used were, sharply curtailed. We mean just that. They have been used far too excessively. It is a means of raising money very easily, but a very dangerous practice.

COMMISSIONER MACKINTOSH: Easy, but the evidence is not clear that it is cheaply.

MR. ELY: The evidence is rather the other way.

COMMISSIONER MACKINTOSH: You have not any rule-of-thumb as to how much is safe?

MR. ELY: None.

COMMISSIONER LEMAN: No rule, or no savings

bonds?

MR. ELY: No savings bonds by any other body than the Dominion of Canada.

COMMISSIONER MACKINTOSH: Well, to turn to another direction, and that is what you have to say about chartered banks and near banks in Appendix H.

I am not entirely clear about your recommendation in respect to the prompt adjustment of call loan rates to fit market conditions. In the first place I gather that the lag in adjustment causes you to borrow from the street; I think you said country banks. Is this in itself a bad thing?

MR. MILNER: Mr. Shaw,would you speak on that?

MR. SHAW: Well, this had the effect, Dr. Mackintosh, that the so-called country bank market expanded very rapidly and significantly in the period from August 13, 1959, to September 29, 1960, when contrary to the usual practice there was no difference in the interest rate scale applied to dealer borrowings from banks. The usual practice is that there would be interest rates scaled from the low to the most high marketable securities, or short-term rather with the lower rates scaled up to the high rates of long securities. This is the longest period in our epxerience -- perhaps not the longest period, but it so happened the rates were set at a flat $5\frac{3}{4}$ per cent at the initiation of that period and were left unchanged for some 14 months. This is a rate which would have made it extremely difficult for us to carry on if this were our only source of borrowed capital.

As a result the dealers were compelled to look elsewhere, and I think we said with no little success. This developed by reason of an apparent indifference to the dealers' problems on the part of the chartered banks. Their reasons probably were very good.

COMMISSIONER MACKINTOSH: Maybe they were elsewhere engaged.

MR. SHAW: They were perhaps elsewhere engaged; at the same time the dealer found that there were other sources of capital which grew to such large proportions that we became alarmed as to the size of them and started to measure that market. We put into effect machinery for measuring it, which has remained since.

I think the recommendation states that if the banks could share the dealers' ideas that the rates would be periodically reviewed with a view to keeping them competitive with other sources of borrowing loans, the dealers in most cases would prefer to return this trade to the chartered banks.

COMMISSIONER LEMAN: Is that because these country banks are in and outers, or what?

MR. SHAW: No, it just imposed a good deal more of a different procedure which was different to what we have been accustomed. That is not to say that now this market has been established it would disappear entirely. There are many reasons why this sort of thing has become of value both to dealer and suppliers of capital.

COMMISSIONER MACKINTOSH: Would you not assume

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that the banks are now aware of this historic experience?

MR. SHAW: We do so assume, and we had every reason to believe that during the period that they were aware of what was happening. However, as you suggest, they were going through some problems of their own at that time and had no difficulty in finding useful employment for the funds that they then had.

Toward the end of the period we took occasion to call upon one of the banks and discuss the matter with them. They were quite aware of what was happening. I do not suggest for a moment it was deliberate indifference. It was simply that we had to seek capital on a basis that would permit us to carry on business profitably.

COMMISSIONER MACKINTOSH: Well, what is uncertain in my mind is whether this is simply the working or the developing of a market under a set of strenuous circumstances.

MR. SHAW: It was something that developed under this impetus that unless something of the kind that we recommend takes place, it is here to stay.

COMMISSIONER LEMAN: Is this a case of there ought to be a law, or what?

MR. SHAW: No, the suggestion that we make, through the Commission rather indirectly to the banks, is that they might like to have some discussions about it.

COMMISSIONER MACKINTOSH: Well, I have reason to believe the banks may hear of this.

You also recommend, in a generous frame of mind, the removal of the 6 per cent ceiling on bank

interest. Does this relate to the same desire for flexibility of rates?

MR. SHAW: It does indeed, sir. During our conversations with the banks at that particular time which by coincidence coincided with the first change that we had in the scale, the position was taken by the banks that by reason of the fact that in a period of very tight money when the banks might have every reason to expect that they could have obtained a higher return upon their loan resources, they were held to the 6 per cent level. So, for that reason when the rates began to decline, we felt there was some justification for retaining the higher rate for a somewhat longer period than would normally be warranted to make up for the lost opportunities to the bank, had they not been on a 6 per cent ceiling.

In addition to that we were inclined to take the view that the reasons that existed for the original imposition of this restriction were because in the first instance the position was taken that the banks should not loan at 7 per cent because if they did they were incurring greater risks than they should take and, secondly, that any rate higher than 7 per cent was a rate that the agricultural community could not support. These were two reasons cited in the MacMillan Report of 1933. If those were the reasons for the imposition initially we felt that they still existed, and we take the position that this ceiling is anomalous and presents an undue restriction on freeom of contract, if you like. We felt that they ought to be allowed to occupy

COMMISSIONER LEMAN: No ceiling at all, and it is rather interesting to note in the report that they recommend the ceiling be removed.

COMMISSIONER BROWN: Perhaps the bankers prefer that we do not make a recommendation in case we reduce it to five per cent!

COMMISSIONER MACKINTOSH: In paragraph 29 of that section you complain of the residual nature of the chartered bank investment policy in that it leads them to sell securities when the demand for loans is high and buy securities when the demands for loans is low. Now, admitting that the experience of 1959 was a bit strenuous, is not that a normal working of the market in the financial intermediaries?

MR. SHAW: First of all, we did not try to make it sound too much like a complaint, we pointed out that this was really what happened; that the security markets -- and certainly this did happen in 1959 -- were subject to pretty severe impacts as the banks added reserves to look after the pressure that was there on the part of their customers for added loans, and we point out only that this does pass through to the subsidiary markets and through them to the dealers some pretty sever shocks from time to time.

We go on to point out that this applies not only to their current deposits but to all deposits including the steadily rising savings deposits.

COMMISSIONER MACKINTOSH: However, I would take it that there is evidence that the chartered banks were not the prime movers in this series of events?

MR. SHAW: No, we presume that is right.

COMMISSIONER LEMAN: What has it reached now?

MR. SHAW: I think it is 5.65. What day is it?

COMMISSIONER MACKINTOSH: I find also there appears to me to be a contradiction in a couple of the following paragraphs.

You speak of the tendency of the banks, the chartered banks towards increasing liquidity in their investments. You quote with some approval the suggestion of the governor of the Bank of Canada some years ago that you might look towards longer investments in the light of the amount of their savings profits, and then I am not sure whether you recommend or not ---

MR. SHAW: May I interrupt you, sir?

COMMISSIONER MACKINTOSH: Yes.

MR. SHAW: We were very careful not to make a recommendation on this point. We said there:

> "This suggests as an avenue of exploration the possibility that personal savings deposits held by the Chartered Banks..." --

COMMISSIONER MACKINTOSH: I know you do not make the recommendation there, but you did then say that the banks continued to refrain from making term loans?

MR. SHAW: That we did make a specific reference to.

COMMISSIONER MACKINTOSH: It is not because it is a longer term investment, according to your previous statement. What is the reason for it?

MR. SHAW: We realized that there might be some apparent contradiction there, although we do not think that there is, but our objective is -- rather, shall we say that our approval of the present arrangement and agreement amongst the banks to refrain from making such term loans carries our full approval. What we were concerned about the time before this agreement came into effect was the steadily increasing practice on the part of the chartered banks to negotiate directly with corporate would-be borrowers; loans for periods of repayment longer than the normal period of that loan and for purposes which were clearly capital purposes and taking on the full amount -- taking this as an investment for the amount of these loans it made.

COMMISSIONER MACKINTOSH: That is the alternative to the client issuing the securities.

MR. SHAW: Quite, and we took the position that in many of these instances that the borrower in normal circumstances would have entered the long term market and gone through the normal underwritings to the advantage of the borrower!

COMMISSIONER MACKINTOSH: At least!

COMMISSIONER GIBSON: On this same point, on his yield of the banks making small term loans under one-quarter million dollars ----

MR. SHAW: Our recommendation is term loans beyond a reasonable amount.

COMMISSIONER GIBSON: I did notice that. You do not express any view on that?

MR. SHAW: We take no exception to loans of a reasonable amount under the circumstances. As a matter of fact, I think you will find somewhere else in our brief that in the small business area there are comments as to the hope that the banks might be able to look after ---

COMMISSIONER GIBSON: I did notice that, and that is why I asked the question.

MR. SHAW: The emphasis is on size or smallness.

COMMISSIONER MACKINTOSH: There were a couple of sentences which I confess I did not understand. In paragraph 58 of that section at the beginning you say:

> "There has been concern expressed in recent years as to the responsibility of the dealer in the placement of the securities of 'near-banks'. The pressure exerted within a firm to secure funds for a client have, undoubtedly, resulted in the placement of securities of dubious quality."

I do not just understand what the mechanics of this were, so to speak.

MR. SHAW: Well, this has to do with so-called corporate paper; a market which has developed

and extended considerably in the last short while.

As I say, our interest is in the development of this market and we recognize in many cases that it is an advantage to the corporation, the borrower, to give the accommodation which he values, although I personally am not aware of any cases where it clearly states that securities have been placed, but members of my committee maintain that they were aware of such instances.

The definition of the word "dubious" was not too clear. However, as far as we are concerned I think we feel that this is an area where great care should be exercised; that a dealer who sets up this type of paper should make available to the lender the information which will enable him to measure the quality of the loan that is being made, and I am fearful as to where the relationship between the dealer and the corporate bank may lead. The dealer could make available accommodation to a corporate client in some instances which might ultimately lead to trouble.

COMMISSIONER MACKINTOSH: And when you say "pressure within a firm" you mean pressure within the dealer's firm?

MR. SHAW: That is right, pressure between the dealer and his corporate clients.

The danger that we are concerned about is that this type of loan accommodation as it might be obtained by the corporate buyer at a time when he had to protect himself in his own line of credit

[illegible]

with the bank, so that should it turn out that he could not renew such a loan, he may find himself in a position where his bank would be unwilling to provide the funds to repay and it would cause an incident in the market which he would very much like to avoid. There has been to my knowledge no such instance so far.

COMMISSIONER MACKINTOSH: I take it this paragraph is an admonition to your own industry to watch itself rather than a recommendation?

MR. SHAW: That is something for the record --

MR. MILNER: It is exactly a similar security to those provincial -- those short term provincial notes where it would be a simple thing from my point of view.

COMMISSIONER MACKINTOSH: Mergers with the different agencies?

MR. MILNER: Yes, the corporation market has been a very large one and a very sound market in the long run for corporations as a whole, and you are quite right to say that it is an admonition to ourselves to be sure we do not go too far and get one that cannot be repaid.

MR. SHAW: It may well be that the development of the bank's acceptance of this market, which got off to a start in rather an unfortunate clime might obviate these dangers and provide this kind of accommodation, but I do not know.

COMMISSIONER LEMAN: You reiterated this

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

morning the assertion that you are willing to take full responsibility for the distribution of any kind of security.

MR. MILNER: We take full responsibility.

COMMISSIONER LEMAN: Would there be any situations, say, where this could be embarrassing or that this is the case?

MR. MILNER: That is it exactly.

MR. ELY: I think I can add to this because we do a large business in this type of thing. I think most dealers probably have an approved list of corporate borrowers for whom they will raise money, but when it gets down to the dubious quality they do not do it.

COMMISSIONER MACKINTOSH: Now, I have another question on your recommendations. I would like some further explanation of recommendation of (3)(b) which says:

> "..that there should be no further extension, beyond the relatively few cases of long standing which may exist, of the inclusion of banks and syndicates underwriting corporate securities for resale to the public,"

That is at the end of the paragraph. Exactly what is the problem there?

MR. SHAW: There is a further section to that sentence which you didn't read:

> " particularly where such inclusion would place the bank in the dual position of banker

and underwriter and where the sale of corporate securities is for the income bank loans."

As a matter of fact, there are very few instances where the chartered banks are members of corporate underwriting syndicates. Those instances which do exist have been in existence for a long time and were entered into for very good reasons at the beginning. We make no recommendations for changes in that area and we have no reason to believe that the banks have any ambition to restrain their activities in this direction and we express the hope that they have no such intention.

COMMISSIONER MACKINTOSH: I take it that having admonished your own industry you are now admonishing the banks?

MR. SHAW: We are telling them how happy we are with the status quo.

COMMISSIONER BROWN: How about the present restriction in the Bank Act of banks' names appearing in them, in the advertising of underwriters?

MR. SHAW: We make some mention of that in the body of our appendix and as it now stands it is expressly laid down that the name of any chartered bank may not appear in the prospectus of its securities.

COMMISSIONER BROWN: But there are participating securities -- it is in the Act that you should not, but in your opinion is the Act right or not?

MR. SHAW: I am sorry you added that last bit, but I was going to say that the reason they don't appear is that the Act says they may not appear.

COMMISSIONER BROWN: The Act is up for discussion.

MR. SHAW: And we raised the question as to the

intent of that restriction at the time the Bank Act was revised in 1934, or whenever it was. I wouldn't care to express -- perhaps if you restate the question.

COMMISSIONER BROWN: Let me restate the question. In view of the fact that banks are participating in such underwritings and they are members of the syndicates, do you think that the Act should be amended or that their names could or should appear in the advertisements?

MR. SHAW: To speak personally, I think that the participants -- all of the participants in these syndicates should be prepared to make themselves known as members of the syndicate, that is a personal view.

COMMISSIONER BROWN: Do any of the other representatives here care to express a personal view?

MR. ELY: I will subscribe to that; they have a liability and there is no reason in the world why their names shouldn't appear in the Act.

MR. KINNEAR: That is the part on full disclosure.

COMMISSIONER BROWN: Is there an association viewpoint?

MR. MILNER: It was never brought up in our discussions. I think if you were to canvass the industry as a whole there would be a divided opinion as to whether in the revision of the Act, whether they should be permitted to, but you have heard some of the people here say that they would be quite prepared to not exactly recommend it but have no objection to that appearing.

[illegible]

COMMISSIONER BROWN: You apparently had some views at the time on your mind or some arguments against having the names appear; would you care to state them?

MR. MILNER: Well, I think now we have attempted in all instances to keep anything selfish out of our presentation.

I think it would encourage the banks to do more of our business than they are doing now, and they are doing a fair amount at the present time, as we well know.

COMMISSIONER BROWN: Do you think this might encourage other potential borrowers to approach banks?

MR. MILNER: To attempt to get them for their name.

COMMISSIONER BROWN: Are there any other points of view that there could be expressed?

MR. COX: I , for one, as a personal observation, would not like to have the banks' names appear. I agree that I think it would encourage them to try and do more business in this direction. I think it may encourage some borrowers to go directly to them to obtain their funds from possibly an underwriting or term loan. There is one item on term loans that perhaps should be mentioned, that they are potentially inflationary to the extent that a bank grants a credit or deposit to the borrower and it is not matched by withdrawal in the banking system of savings from accounts of individuals who might be buying the securities.

COMMISSIONER GIBSON: But if there is no increase in the money supply, why is a term loan more inflationary than a short-term loan?

MR. COX: It is not, except it stays as a permanent part of the supply until it is repaid.

COMMISSIONER GIBSON; It does not turn over as much.

MR. COX: If you loan money for 5 years it is likely to be there for five years. If you loan it

through the normal banking procedure, it is likely to be repaid, but if you continue this thing ---

COMMISSIONER GIBSON: Well, if it adds to the money supply, what you say is obviously correct; if it does not add to it I cannot see it has any effect on any kind of loan.

MR. COX: Well, I understood this was the thinking of the Governor of the Bank when he started proposing term loans.

COMMISSIONER GIBSON: That is was inflationary?

MR. COX: Yes, and that it could lead to ---

COMMISSIONER GIBSON: In proposing the term loan?

MR. COX: Yes. Isn't that your recollection of it?

COMMISSIONER GIBSON: I think this was perhaps at an inflationary time.

MR. COX: Yes.

COMMISSIONER GIBSON: And I think his thinking was perhaps he wanted the banks either to borrow it and long-term borrowers to go out and borrow on the market, and obviously he wanted to restrain any increase on bank credit, but just the act of making a term loan, if there is no change in the money supply, how can that ---

MR. COX: No, if there is no change, but there is a chance there will be, is there not?

COMMISSIONER GIBSON: It depends on what the central bank does.

COMMISSIONER MACKINTOSH: I have one or two

questions on stocks, some part of which has been covered already. Incidentally, I find a couple of sentences in an earlier section which I think convey an impression other than intended. Back in Section I, paragraph 12,a couple of sentences of which the misleading part is clear if I reverse it. It says: "The small investor depends almost entirely upon his investment dealer... etc.,... for guidance within his investments ..."

Immediately before that: "Very rarely will the small investor be found who owns one or two good investment grade stocks."

MR. KINNEAR: I was afraid you would catch that, sir.

COMMISSIONER MACKINTOSH: I gather what you mean is that the job of educating the small investor and bringing him up to some degree of sophistication is a difficult job?

MR. KINNEAR: That was not worded that way when we saw the last draft. How it got this way, I am unable to explain.

COMMISSIONER MACKINTOSH: Another thing I wanted to ask about: You have considerable reference here to the degree to which institutions buy stocks. How far do you think legislation, regulation, bookkeeping, convention, the form of trustee laws, conventions of the life insurance investment departments and valuation requirements -- how far do they inhibit the number of these institutions or bias their actions in respect of purchase of stocks? Are there definite barriers, so

to speak, in the market.

MR. CRETZIANU: Do I understand that your question is, are life insurance, for instance, prevented by some of the regulations to invest in equities? There is a limit of 15 per cent.

COMMISSIONER MACKINTOSH: Oh yes, I know that, but almost none of them are at that.

MR. CRETZIANU: No, far from it.

COMMISSIONER MACKINTOSH: More precisely, do you think that trustee laws, laws governing trustee funds ought to be widened?

MR. CRETZIANU: Well, they have already been liberalized. I don't think that this is any obstacle at the moment.

COMMISSIONER MACKINTOSH: You don't think it is any obstacle?

MR. CRETZIANU: No.

COMMISSIONER BROWN: Well, could we clarify that: Have trustee acts been liberalized so they can buy common stocks?

MR. MILNER: Not as such, but the legal practice today -- the lawyers in drawing up wills have covered it pretty extensively. In other words, the modern will no longer restricts investments to securities.

COMMISSIONER BROWN: That is not quite the same thing.

COMMISSIONER MACKINTOSH: Surely, it was always true that a man could make his will as he liked?

MR. MILNER: Yes, but it was only the last

20 or 15 years that there has been this marked change in the types of wills that the trust companies recommend and lawyers recommend just to be sure that they are not restricted completely to the trustee acts in the various provinces.

COMMISSIONER BROWN: As I understood Dr. Mackintosh's question, it was whether in your opinion the trustee acts should be liberalized to permit this investment in equities?

MR. CRETZIANU: I don't have the text here, but there have been relaxations on investment restrictions covering trustee pension funds.

COMMISSIONER BROWN: Trustee pension funds?

MR. CRETZIANU: Yes.

COMMISSIONER BROWN: We are talking about the trustee act for trustees.

MR. CRETZIANU: No, I was meaning the trustee pension funds. There have also been various measures to permit the sale of variable annuities of life insurance companies which is also a movement in the same direction.

MR. MILNER: To answer the specific question, trustee acts of the various provinces -- and this is purely a person viewpoint -- but, in my opinion, I think the present restrictions probably help a lot of the very small people to conserve their money. In other words, the people who don't want to come under the trustee act have plenty of ways of avoiding it: In the actual wills, as I say, is the simplest method, but I would rather tend to leave the trustee acts where they are. I would like to have somebody else comment on that.

COMMISSIONER MACKINTOSH: I am not particularly concerned with the trustee act. I wondered if the industry feels there are rigidities which prevent the market from being as free as it might.

MR. WADDS: I am in inclined to agree with you as far as the small individual is concerned. I think in some cases of estates administered by trust companies, and where they were set up several years ago, there could be more liquidity in this by a change in the trustee act. For people who derive a living from these estates, I have seen legal restrictions placed upon them which resulted in a certain amount of hardship, and that is the only reason I would say there would be some sense in taking some of the restrictions off.

COMMISSIONER MACKINTOSH: If I could ask a last question as the time of adjournment is approaching, do you encounter reluctance to show a bookkeeping loss as a barrier to complete freedom of access to the market?

MR. SHAW: In terms of equity?

COMMISSIONER MACKINTOSH: Yes -- well, not only equity.

MR. SHAW: I think it could be safely said that the life insurance companies, some of them, in their internal policies prevent their investment department from investing freely if there is a loan involved in bonds, but the equity holdings of life companies are not large enough to make it a significant factor there.

COMMISSIONER MACKINTOSH: Thank you.

THE CHAIRMAN: We will adjourn now until 8.45 tomorrow morning.

--- Adjournment

2.

Royal Commission on Banking and Finance

The Investment Dealers' Association
of Canada. (concluded).

Hearings held at

OTTAWA

Vol.		Date.
27	(Relates to Brief at Vol. 22A)	July 12, 1962

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Thursday,
July 12th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Thursday, July 12, 1962.

--- Upon resuming at 8.45 A.M.

THE CHAIRMAN: The proceedings will now resume.

COMMISSIONER GIBSON: Gentlemen, yesterday we asked quite a lot of questions about the operations of your business and today we are going to go to a bit broader field and ask you questions about your views on monetary and financial policies.

I propose to start by asking a few questions about exchange policy and international capital movements and since you have made your recommendations here, of course, the official exchange policy has changed. In Recommendation (4) you ask us to consider the desirability of a pegged rate. We have a pegged rate. What we would like is to get your views on the significance for monetary policy of having a pegged rate and its effect in the basic picture, the significance for monetary policy and for the securities market. Would any of your members care to comment on this?

MR. MILNER: Mr. Gibson, I am going to ask Mr. Cox to speak on this subject.

MR. COX: Mr. Commissioner, the first thing that perhaps arises from having a pegged rate is the Bank of Canada's policy can no longer be dictated by what they feel is appropriate action from internal economic conditions. They have also got to regulate interest rates to take care of capital flows. This, of course, I suppose could lead to a very peculiar

situation where in a recession you would have to have higher interest rates and perhaps conversely.

COMMISSIONER GIBSON: In other words, it might be what one would describe as a perverse reaction?

MR. COX: Yes.

COMMISSIONER GIBSON: Do you envisage this?

MR. COX: I never was very good at looking forward into what might happen. This perhaps is the thing that we have the greatest difficulty with in our business -- the difficulty of forecasting and it perhaps is made more difficult now because the bank has to serve two masters instead of one under this policy.

COMMISSIONER GIBSON: Do you see wider variations in interest rates as the result of having pegged the exchange rate this year, that is, other things being equal?

MR. COX: I don't know about wider. We have had some pretty wide swings already in the past few years. These swings might become more frequent rather than wider but this is just a personal view of my own. I do not know how you could answer that question with any degree of accuracy.

COMMISSIONER GIBSON: What you were implying was it put more emphasis on changes in rates?.

MR. COX: Yes.

COMMISSIONER GIBSON: Do you see any other implications of a fixed exchange rate?

MR.COX: Not off-hand. Perhaps somebody else would have a few thoughts on the matter.

COMMISSIONER GIBSON: Would you say, for example,

to be more specific that with the fixed rate our security markets would be more likely to move in line with those in the United States or less in line with those in the United States?.

MR. COX: I think they would more inclined to move in line with the United States markets. They always have but perhaps more so now.

MR. HUNTER: If I may, Mr. President, I think experience has shown us that where there has been stability for any lengthy time the Americans are more inclined to buy our interest bearing securities. That applied even when the dollar was selling at a high level and I think now we have come to a fixed rate and one can become convinced that that can be maintained, it is altogether likely they will come to this market and start an inflow of capital. There was some indication of that recently.

COMMISSIONER GIBSON: You are talking of the long-term operations?

MR. HUNTER: Which are the important ones. The short-term ones do not help us in the end.

COMMISSIONER GIBSON: I would like to go a little farther. You emphasize in your recommendations the importance of allowing free movement of capital in Canada from abroad. This is in Recommendations (5), (6) and (7) and you use the words: "Repeated access to the Canadian market" and you also suggest it would be a good thing if this inflow of capital came in the the form of debt securities rather than equity investment. In connection with this what is your view as to our

tendency to encourage capital in the present decade as compared to the last decade -- more or less?

MR. COX: Well, that is a pretty hard one to answer, I think Mr. Commissioner.

COMMISSIONER GIBSON: Very important, though.

MR. COX: Well, we presumably will continue to require more capital than we are able to generate internally but we also have excess plant capacity and it becomes a question as to whether this is as desirable a country for a foreigner to invest in as it was in the early 1950's -- 10 years ago. I do not know that I can say much on this subject. I am not an expert by any means on this subject. Perhaps some of the others here would have some comments to make.

COMMISSIONER GIBSON: We have been very dependent on foreign capital in the 1950's, particularly the latter half?

MR. COX: Yes.

COMMISSIONER GIBSON: It would be very interesting to have your views as to whether this degree of dependency is likely to continue?

MR. MILNER: The grest influx of foreign capital into this country came in the last 15 years, particularly where there was this confidence all over the world that Canada had a very great growth potential, a greater growth potential in North America than the United States but I think some of the actions that have occurred in the past two or three years have disillusioned a lot of so-called foreign investors as to

the stability of this country. But basically the reasons that brought the money here, say, 15 years ago are still here. If the monetary policy could be adjusted to meet the economic conditions that exist today I would look forward to more capital coming in again and I think if we are going to have a growth like we had since the past war I do not think it is possible to generate that amount of money in Canada.

COMMISSIONER GIBSON: In other words you are saying today the rest of the world do not want to put more money in here for the time being but we still need it?

MR. MILNER: We still need it.

COMMISSIONER GIBSON: Do we need it on the same relative scale that we needed it in the last half of the 1950's?

MR. MILNER: I should hope so.

COMMISSIONER GIBSON: As much as we needed it in the 50's?

MR. HUNTER: We will need it to balance our foreign exchange picture. Equity capital may not want to come to Canada as much as it has in the past over the years but if our interest rates are sufficiently attractive and if we follow through the measures that have been suggested it is quite conceivable there could be a very strong demand for our interest bearing securities which create quite an inflow of capital.

COMMISSIONER GIBSON: Well, let us look at it the other way. Do you think we can reasonably expect to generate a sufficient level of dollar earnings to

pay these increasing service requirements for foreign capital over the next few years? Is that a reasonable expectation or is it not?

MR. SHAW: Aren't we dealing with a somewhat different set of circumstances now, Mr. Commissioner, than during the period that you have alluded to? We went through a period where we were doing on the investment sector of our economy on our public and private investment stocks more than the rate of over 25 per cent of the gross national product. While that was going on obviously that sort of programme could not have been maintained out of our own resources. That sort of a programme was probably not initiated entirely by our own thinking. The need obviously is not going to be as great once we have got that heavy programme of investments completed. Surely we must be approaching a period where the results of that investment will begin to make their contribution to the problem, that a good deal of this productive equipment that was put into place with that kind of money must soon -- although admittedly not as quickly as some of the investors might have hoped -- that this must soon begin to makes its contribution in the way of productivity and internally generate funds so that in the future we could very well not have the need for quite the heavy proportion or percentage of our capital investment to come to us from outside.

COMMISSIONER GIBSON: Would you think it reasonable to estimate in terms of a need half as great as the average in the 1950's or something of that order?

MR. SHAW: I think we have made the transition so quickly from one side to the other, we were in the position of heavy inflow and suddenly we are in the position where we are now on balance on an outflow position. It would be presumptuous to suggest any measure of degree of normal conditions. All I would like to suggest is that the need is not likely to be as great as the experience has been in the past and we will have a better chance of generating a better proportion of the capital needed in this country internally from here on than perhaps would have been the case from 1946 to 1956 or 1957.

COMMISSIONER BROWN: Recommendation No. (6) there says:

> "...that, to the extent that it is necessary or desirable to import capital from foreign countries, Government of Canada policies be established which will encourage the purchase by foreigners of debt securities rather than equity investments of all kind."

How are you going to measure this "necessary or desirable"?

MR. COX: Well, "necessary" would be the result of our trade balances and our invested items -- what is the balancing item. That would be the necessary item, would it not?

COMMISSIONER BROWN: What are the long-term implications for borrowing to meet your current debt services?

MR. COX: This, of course, depends upon our ability to pay it, I presume, when translated into

what kind of trade balances are we going to have. Are we going to be successful in stimulating exports to the point where we have a favourable trade balance? This would look after the important part of the complete balance of payments. If we do not do that I think we are getting in over our heads.

COMMISSIONER BROWN: At the moment we need several hundred millions of dollars to service our present debt securities?

MR. COX: Yes.

COMMISSIONER BROWN: To the extent that we cover our requirements for further borrowing are we not making a greater problem for ourselves?

MR. COX: I think we are if we do not manage to counteract at the same degree, to a considerable degree, by meeting our trade balance.

COMMISSIONER BROWN: What policy do you suggest we ought to adopt to accomplish this?

MR. COX: Well, it becomes a question of productivity, I would think, how competitive are we in world markets and a lot of these things we cannot entirely control. The other question is are people abroad going to require what we can produce. It is only a question of price at which we can produce it but will they want it. Is there a market, in other words.

COMMISSIONER BROWN: You are suggesting a lot of this is entirely beyond our control?

MR. COX: A lot of it. I think anything the Government can do to encourage, stimulate and provide us

with a suitable climate which would enable us to become more able to produce what the world wants from us the better our chance of getting our house in order.

COMMISSIONER GIBSON: Now, to return to the investment point, you ask us, that is, the Commission, to recommend to maintain a favourable investment climate in Canada to be sure that this will be available when needed. Would you be a little more specific about the kind of policies that are required to maintain a favourable investment climate?

MR. COX: We have had such an about-face from the climate that did exist, that encouraged the inflow of capital, things like withholding taxes on fixed income securities and on balance budgets and things like this, these all hinder the possibility or likelihood of inflow. I would think the Government should take some steps as soon as possible to remove these obstacles. Perhaps we are moving in that direction now in the late June announcement from the Government.

COMMISSIONER GIBSON: Specifically withholding tax and the budget deficit, in your view, is too large?

MR. COX: Yes, and it keeps on as a deficit regardless of what kind of business conditions exist in the country.

COMMISSIONER GIBSON: Well, this is not altogether true. Since 1957 and 1958, let us, we have not had a high level of business activity in relation to our employment?

MR. COX: No.

COMMISSIONER GIBSON: So this is a period that

there has been a pressure. Right through this period we have had a rate of unemployment higher than at any time since the war?

MR. COX: I think that is true but looking at it from the other point of view we have had a couple of complete business cycles in that area and now we are making some progress in current dollar treatment.

COMMISSIONER GIBSON: We made some in 1961. Up to then we were just going like this (indicating) for four years?

MR. COX: Yes.

COMMISSIONER GIBSON: Are there any other thoughts you have about the favourable imvestment climate?

MR. COX: Well, taxation in general, of course. I think this is something that should be thoroughly studied and investigated from the basis for providing greater incentives.

COMMISSIONER GIBSON: Part of this recommendation -- or actually it is in Recommendation (6) is we produce the kind of atmosphere or climate to encourage the purchase by foreigners of debt securities. Would you like to talk about it in those terms? First, why do you make that recommendation?

MR. COX: Mr. Milner, would you like to talk on that?

MR. MILNER: Mr. Gibson, there has been a lot of publicity given in the past four or five years to the effect of a number of our larger corporations, the control of them passing into foreign hands and I

think probably the chief objection to the passing into foreign hands is the fact that if they are branches of, let us say, American concerns it rather hinders the possibility for research activities in Canada. The research is usually done at the source rather than in the country that they are operating in as a branch subsidiary and one of our troubles has been -- and especially in secondary industries of this country is probably the lack of sufficient skills and the right kind of people to go into it.

I think that basically the problem is not part of your actual, whatever you call it.

COMMISSIONER GIBSON: The terms of reference?

MR. MILNER: The terms of reference. Our taxation has not been seriously looked at for a number of years. In fact,it has been done in bits and pieces over the last 25 years. Surely the right answer is to thoroughly examine the taxation picture, and not by means of a Royal Commission which would take three years to complete, and I say that with reference to a viewpoint of urgency.

What we need to do today is to encourage industries in this country to become competitive in world trade.

I think one of the finest things that has been done recently was the formation of the productivity council. I think it is most unfortunate that the government in its judgment did not put labour in its proper form on the productivity council. Whether that can be corrected or not, I doubt. What has been the success and great resurgence in Europe unquestionably is the result of getting government, labour and management to work together. If we could attack this problem from the source rather than in the other way, I think the results would be much better. If this country was more economically sound I feel we would have no problem in getting good money or any other kind of money.

I feel that we have a great loss of money as a result of the difficulties in this country of

accomplishing mergers of companies. This again involves a question of pure taxation. We have a Federal Companies Act and Provincial Companies Acts but I would suggest we would be much better off in designing these acts in such a way as to facilitate the creation of larger companies rather than smaller companies. I do not mean to suggest that we should merge Eatons and Simpsons, or Imperial Oil and British American Oil, but in the echelon below that I suggest small companies would be more efficient if they became larger companies. I would be the first one to admit that this would affect unemployment or employment, but at the end of a reasonable period of time, say a year or so, if we had more successful smaller companies, I think the unemployment situation would take care of itself.

COMMISSIONER GIBSON: You are ranging around and past the borders of our specific reference. What do you feel the investment dealers could do to promote this business of selling debt securities abroad? A number of the large members of your Association have operations in New York. Is this something you feel that the members of the Association could make a fairly major contribution towards?

MR. MILNER: Mr. Wadds, would you care to answer that?

MR. WADDS: I would say, sir, that I think the image of our government in this country abroad has a national importance. I have a feeling that until the feeling that Canada has a stable and sound

economy returns to foreign buyers of securities that our operations in foreign markets are going to be somewhat restricted. This is to a large extent a psychological thing rather than a question of dollars and cents. There is a resentment right now towards the whole Canadian economy and market, and unless we are prepared to sell securities at almost penalty rates in the United States, we will find it rather difficult to overcome this feeling of resentment toward those things which have occurred in this country in the past two years.

COMMISSIONER BROWN: Could you be more specific about the resentments?

MR. WADDS: Certainly the prime one was the taking over of the British Columbia Electric Company. A second resentment is directed toward the deficit financing that has taken place in this country for some years. I should also mention the fact that today we have a disturbed political situation at the federal level, and we also have mechanical problems created by such things as the withholding tax. There is certainly a resentment toward the nationalism which we witnessed when this holding tax was put on. All of those things have destroyed the confidence of foreign investment.

MR. HARRIS: There is one thing that frightens me at the present time. We look at our unemployment in Canada, but I suggest that similarly in the United States they are concerned with American problems relating to money outside of that country.

There is now a program of moral persuasion in the United States in an attempt to restrict Americans putting short term money out of the country.

COMMISSIONER GIBSON: Short term money did you say? You do not refer to long term money?

MR. HARRIS: Some of this money has recently gone into the long term field, but there is a definite feeling that the flow of money should be kept in the United States if at all possible. This in a manner of speaking is a factor which has developed within the last year or so, and is something over which we have no control. I am rather frightened by the prospect of the effect of this program, certainly in respect to short term money. In spite of the interest rates, and this seems to be the excuse, short term funds have not been coming in at the rate at which one might have expected within the last few months.

COMMISSIONER GIBSON: Is that why you put the emphasis on recommendation number seven concerning the withholding tax on short term money? I wondered why it was applied to short term money here?

MR. HARRIS: I agree that you cannot take it off one and leave it on the other. I believe you must have a concerted policy in this regard.

On the money market through interest rate changes you can move capital back and forth quite easily, but the withholding tax has been a problem with which we have had to deal. Our markets are very small and it is only in respect to government bonds and treasury bills that we have had an adequate supply, and I note that

we have moved a substantial amount of funds in that regard. Certainly with respect to treasury bills where the taxes are imposed at the time of issue rather than at maturity it has created a problem in mechanics, although perhaps a nuisance problem.

COMMISSIONER GIBSON: You are suggesting that they be removed in the short end?

MR. HARRIS: I was thinking at the present time they should be removed in the short end, yes, although they should be removed in all categories.

COMMISSIONER GIBSON: Supposing they could not be removed in all categories, you would then recommend that they be taken off the short end? If so, how do you fix this problem from the mechanical point of view? Where do you draw your line?

MR. HARRIS: I draw the line on the shorts. When this brief was written the situation was a little different to what it is now from an economic standpoint. We did not have a financial crisis such as has since developed. Secondly, and this was suggested as far as the short end of the market is concerned, our present situation, and I think that we would be unanimous in this suggestion, that the withholding tax legislation should be looked into. This is a nuisance tax. It is not levied on everybody. As you know, there are only certain groups such as those of a religious character, educational and scientific bodies that do not pay that withholding tax. Corporations can lay off the withholding tax against internal taxation. It is basically only levelled on accounts such as state

funds, or something like that, or pension funds which in the past have been substantial ~~borrowers~~ buyers in Canada of securities both internal and external. This is not a particularly equitable piece of legislation and represents mainly a nuisance tax.

COMMISSIONER GIBSON: So you are objecting to it on two grounds; one that you do not like the tax and, secondly, that the incidence is uneven?

MR. HARRIS: That is quite true. This is one of the difficult taxes. Although people often can recapture the tax they are discouraged from doing so because of the trouble involved in going through the motions. They feel it is just too difficult to bother with.

COMMISSIONER BROWN: I would just like to explore some of these resentments that you talked about, particularly with reference to your recommendation that this Commission make some suggestions as to how these can be handled.

First of all, in regard to the British Columbia Electric takeover. Is the resentment directed toward the actual takeover or the method of takeover?

MR. HARRIS: I would say it is largely directed toward the manner in which it was done.

COMMISSIONER BROWN: Now, British Columbia has not been the only province that has been making suggestions along this line.

MR. HARRIS: I would say American investors are well aware of the other rumblings from the other provinces in regard to the taking over of utilities,

but this is the only province that has done so to date, and the manner by which it was accomplished is definitely not popular in the United States.

COMMISSIONER BROWN: What recommendation would you make in line with preventing this type of thing happening? You made a recommendation regarding certain tax anomalies which should be removed.

MR. HARRIS: I would agree with Mr. Milner's redistribution suggestion.

MR. MILNER: Public utilities with particular reference to power utilities, because power is generated within the province in practically all cases -- there is a bit of export between provinces -- with the exception of the Bell Telephone Company, which is in a different category being a national company, it is felt very strongly that could be considered as provincial assets and therefore belong to the provinces. I think there has been a great amount of publicity given to this situation.

In regard to the taxation part of this problem we suggest that the government should look into the situation and devise some method of reimbursing the provinces in respect to federal taxation which is involved as far as power companies are concerned. We hope that such a system would eliminate the reasons which are used publicly for taking over power companies. We do not believe that it is in the best interests of this country to have confiscation of private enterprise in any shape or form, particularly done without arbitration.

COMMISSIONER BROWN: Yes, I was going to say that you used the word "confiscation". Has there been any confiscation as such?

MR. MILNER: Without arbitration it is all confiscation. They simply fix a value -- their own value -- and pay the shareholders that amount of money.

COMMISSIONER BROWN: I do not think you can claim that this has an effect on debt securities.

MR. MILNER: I am not so sure today that a British Columbia Electric bond would not sell higher than a province of British Columbia bond with guarantee.

MR. COX: This changes the investor's portfolio around. He thinks he has got a public utility bond and all of a sudden he finds that he has a public bond which he may or may not want.

MR. HUNTER: British Columbia is part of Canada as far as this is concerned in the investor's mind, and he comes to look at all of our securities in the same light as he regards British Columbia as Canada.

MR. COX: I have been rather surprised in speaking to American investors regarding their concern over that expropriation. They seem to be much more concerned than Canadian investors who also hold the debt instruments. They are much more vocal about the subject than our Canadian companies have been.

COMMISSIONER BROWN: The next thing you mentioned is deficit financing. What different policies

would you suggest the government should have followed in the last few years when we had unemployment running over 6 per cent?

MR. WADDS: I think Mr. Milner is prepared to deal with that subject.

MR. MILNER: I am going to ask Mr. Ely to speak in that regard if you do not mind.

MR. ELY: What is the question again, Mr. Brown? I want to stick to the specific question.

COMMISSIONER BROWN: We were talking about resentments abroad.

MR. ELY: Yes, I realize that.

COMMISSIONER BROWN: It has apparently had an effect in the attitude toward Canadian debt securities.

MR. ELY: Yes.

COMMISSIONER BROWN: One of the points that was brought forward in this regard had reference to deficit finance. I am assuming that this refers to deficit financing at the federal level.

MR. ELY: That is right.

COMMISSIONER BROWN: My question is, during the last few years when we have had unemployment running over 6 per cent, what alternative forms of government policy do you think should have been implemented to satisfy the situation?

MR. ELY: Well, we have created an atmosphere in this country, perhaps at the federal level, that has inhibited the people investing their money in this country, and deficits are one of the first

things brought up in this regard. There are perhaps a few things that could have been done about this. There has been extensive criticism regarding the type of money that has been spent to look after unemployment. Let me be specific as to one case which would probably have saved us a lot of money and we would have had a smaller deficit.

I am not too well versed in this, but this is one of the things that has been brought up. On both coasts there are large fishing industries. Over the history of this country they have never been compensated during the winter but they now are. I do not know whether this should be attacked on a political level or what level, but it seems to be one area among others where the deficit could have been cut down.

COMMISSIONER BROWN: Perhaps we should wait for the Gill Commission report on that subject.

MR. ELY: That might well be. There is no doubt about it that in this area there surely must have been room for good business management so as to bring our affairs into better balance which would have set the climate for investors to put their money in this country.

COMMISSIONER GIBSON: You are saying the deficit was too large, not that there should not have been one?

MR. ELY: I do not think one could find fault with a small deficit, but the deficit was too large.

THE CHAIRMAN: When would you say that it became too large?

MR. ELY: I think it has been too large for five years.

THE CHAIRMAN: One thing I noticed about your recommendations in the brief which was prepared before the last great crisis arose is that as far as I can recall deficit financing is not one of the points raised.

MR. ELY: One of the points that I raised, Mr. Porter, is that our debt has increased by $3 billion in the last five years.

THE CHAIRMAN: Yes, but in your recommendations you have not mentioned that.

MR. MILNER: Yes, recommendation number one, Your Honour, is directed toward that.

THE CHAIRMAN: Yes, I apologize.

COMMISSIONER BROWN: Let us deal with that in a little more detail. It refers to surpluses in years of prosperity.

MR. ELY: The conditions that have existed in the last five years have not been depressive in the main and did not deserve in our opinion a huge increase in our national debt.

COMMISSIONER BROWN: Let us be a little more specific about this because we should like to get some concrete thoughts in this regard. I am assuming that you are not suggesting that an unemployment rate of 6 per cent has to be accepted as normal?

MR. ELY: I do not think it should be accepted. Some rate of unemployment has to be accepted, and if we accept it then it might be dealt with in a way that is perhaps not as expensive in this country.

COMMISSIONER BROWN: With a 6 per cent unemployment figure, one cannot consider times to be prosperous.

MR. MILNER: Mr. Brown, are you sure that it is 6 per cent? I question that figure. I think unemployment has been added to as a result of the payment of benefits to people who have been employed. There are bound to be abuses of a small nature.

COMMISSIONER MACKINTOSH: I do not think the 6 per cent figure came from the Unemployment Insurance Commission. I think it comes from the Dominion Bureau of Statistics survey which has nothing to do with the manner in which people are drawing unemployment insurance benefits.

Now, you may argue that the availability of insurance benefit in some cases leads people to be unemployed rather than actively at work, but by and large the 6 per cent doesn't cover people whom you might say were not genuinely unemployed but merely improperly drawing benefits, so that whether you think it is a bit more or a bit less, I think 6 per cent is real.

MR. MILER: As accurate a figure as you could get of the working people of this country, 6 per cent of which -- I would still question whether that is correct, Dr. Mackintosh. The abuses that have gone on in the unemployment fund, which I say is bound to happen, this might occur all over the world. I don't know what the conditions are in other countries, but we have seen so many instances of unemployment figures that we are perfectly well aware are not correct.

COMMISSIONER GIBSON: I don't think we should get into a discussion of the unemployment; all we are really asking you is do you think that economic conditions were such that it was necessary to run deficits, and if so how much?

THE CHAIRMAN: After coming back to my question, on reading this recommendation more carefully again, I think I will have to withdraw it in part with my apologies. They say that the deficit at the time this was written is too large and that it is dangerous. You don't do that; you soften it and say that the objectives are the approximately equivalent budgetary deficits which may have occurred in recession years -- if we are

going through certain recession years and the deficit is being increased from year to year, the time for surplus would come when the conditions change for the better, according to this recommendation, I would think.

MR. BEATTY: The problem of unemployment has been dealt with by several different bodies and given great publicity. I understand that one of the factors is lack of mobility of our labour forces. Another is lack of skills in the unemployed and a third one is that the Bladen Commission points up the fact that the automotive industry is producing a great deal outside the country to contribute to our balance of payment troubles in importing parts, and so on, and we fail to see why Federal Government deficits affect any of these things unless they are active in tackling the problems themselves.

THE CHAIRMAN: That is not what you have put on the record here. This is the only point I am making; you say now under present conditions that the budget deficit is too great. One of the great sources of our difficulties is that when you prepared this brief prior to the monetary crisis that arose you didn't put in that way, you put it in a much more softened way.

MR. COX: I think this arose from the suggestion that these large deficits were affecting the foreign investors in this market.

THE CHAIRMAN: But you didn't say that at the time.

MR. COX: I don't think we can say that this

financial crisis just happened; this has been building up for several years.

THE CHAIRMAN: I may be wrong, it is some time since I read the whole of this brief and I may not have recollected some of the matters, but what I want to make clear is this; that you say now that the deficit is too large and it may be that people would agree with that under present conditions and with a certain amount of hindsight but it may be if I read it again in the light of this particular point I might find you have taken a stronger position than you seem to have taken on recommendation No. 1, but if that is such a serious item I would have thought it would have been given the very greatest attention by your Association.

MR. SHAW: As I see the position, we think the deficits have been unduly large measured against the achievements that they can find for them in the one area that the Commission seems to be directing their questions to us about, and that is the area of employment. It has been argued ---

COMMISSIONER GIBSON: Unemployment comes up as a measure of lack of activity.

MR. SHAW: The Chairman has just mentioned that these are recession years we have been going through and if they are recession years -- and we say in recession years we should have a deficit, so we are not being consistent and these facts are all right if we can accept that these are really recession years. We admit they are years of high employment and also point out that they are years of high employment and

high income, not necessarily recession years measured by all other criteria you may use and I think our concern is simply that in difficult periods if it is necessary to build up a deficit, it calls for extreme care to ensure that they monies that are being borrowed are being put to the most effective use to deal with the specific problem which we are tackling, and I think that the point Mr. Milner made is a good one.

We didn't, perhaps, examine the national accounts with the care we should have if we were going to pursue this position, but we really have a feeling that a lot of these expenditures which went into the deficit didn't help very much in alleviating the unemployment problem.

THE CHAIRMAN: But aside from that, though, wouldn't your position be that there is a certain point where a deficit would be by its very size dangerous, forgetting what it was used for?

MR. SHAW: Definitely, we feel the deficits are a dangerous amount, and the bigger they get the more dangerous they get.

THE CHAIRMAN: Well, is it necessary to relate the amount of the deficit to the monies which were derived from the deficit and to what they were used for.

MR. SHAW: We come back to the question that was directed to us; what would we have done in the circumstances in the face of the unemployment situation that the country was contending with and we have attempted, in perhaps not too effective a way, to submit some suggestions, but it is a very difficult question to look back and say that something different should have

been done, and I find a great many people today who are complaining about the deficit who didn't complain a few days before the crisis.

MR. HUNTER: May I read something:

"During periods of economic recession and unemployment the practice of deficit financing for the purpose of revitalizing the economy has been generally accepted as a necessary social obligation. However, during the past 7 fiscal years ending March 31, (1955-61 incl.) we have shown cash deficits in six years (with a small surplus in 1957) and the certainty of a deficit in the year ending March 31, 1962. These deficits have occurred despite periods of prosperity which occurred during the years 1955-56, 1958-59 and 1961. These factors, together with the concurrent increase in money supply which has been necessary to finance the deficits, have done a great deal to destroy the confidence of investors in Government of Canada securities."

THE CHAIRMAN: What page is that?

MR. HUNTER: F.33.

COMMISSIONER BROWN: I think the point we are making is this, that the first group suggested that 1951 was the first year of prosperity.

THE CHAIRMAN: I can see you have put yourselves on record more definitely than I had thought.

MR. COX: I think perhaps there is another point in this connection, the desirability of deficits

in a country like Canada. Mr. Towers went to considerable lengths in 1939 to explain to the House Banking Committee that in theory it might work in some countries but it was highly unlikely to work in a country such as Canada. It is fairly generally quoted in Section C here, and our government chose to ignore Mr. Towers' advice and went ahead with deficits and I think it is a very open question whether the deficits have done very much to cure the problem of unemployment in creating an atmosphere where we could use our excess labour.

COMMISSIONER BROWN: I don't think there is much point in labouring this much further. You have said there were years of prosperity and other people apparently don't agree with you and you have nothing really concrete to suggest as to how this unemployment might have been combatted other than the way it was, except a general thesis that its deficits were acceptable in that period, they were not acceptable in the degree that was adopted.

MR. MILNER: Before you close this subject I would like to make this comment. Let us go back five years when the unemployment problem became acute. Had the government taken other steps, such as reducing corporation tax to encourage industry it probably would have increased the deficits during that first year but I would venture to say that had that worked they would have had far less of an unemployment problem today had we encouraged proper producitivity deficit spending in the way it was done.

MR. HUNTER: During this period the unemployment

fund has been virtually used up, which can be added to the deficit.

COMMISSIONER GIBSON: This is getting into the qualitative aspects and I think we are getting a little away from our central interest here.

I want to change the subject a bit now and switch to the subject of exchange in paragraph 37 in Section C. The statement is made there that the Bank of Canada has seldom operated in the futures market, despite the fact that spot transactions may cause a maldistribution of chartered bank cash or require offsetting action. It then suggests that since there are some seasonal movements of funds internationally which tend to reverse themselves, transactions in futures appear to be a simple course; simpler than not having transactions in the futures. Would you care to elaborate on this matter of operations in the futures market?

MR. COX: This, of course, has become outdated because since May the Bank has been very active.

COMMISSIONER GIBSON: They have been active?

MR. COX: Yes.

COMMISSIONER GIBSON: In other words, the policy has changed since the loan was paid?

MR. COX: Just prior to it, I think it was April.

COMMISSIONER GIBSON: And you would say that this statement was now out of date?

MR. COX: Well, it is true to the effect that they never did, as far as we know, use the futures market until April of this year, but since then their activities

have been very considerable. I don't know why we are using it ---

COMMISSIONER GIBSON: You don't have any opinions on that?

MR. COX: I don't know how we could, sir; the Bank of Canada doesn't tell us why they are doing things.

COMMISSIONER GIBSON: But you are working in the market and are informed of things.

MR. COX: But we can be wrong in the opinions we form.

COMMISSIONER GIBSON: But your view leading up to the existing policy, whatever that is, is that the Central Bank should operate in the futures exchange market?

MR. COX: I don't know that I would use the word "should"; I would say that the Bank of England and other European central banks, as well as the federal reserve, have found it a very useful thing to do.

COMMISSIONER GIBSON: Would you give us the reasons why you think it is a useful thing to do?

MR. COX: In controlling the "hot" money that can move on a hedged basis; operations in the futures market can change the relationship between the spot rate and the futures rate.

COMMISSIONER GIBSON: You say that the main reason for a central bank going into the futures market was in relation to movements of short-term capital and not in relation to ordinary commercial transactions, that the market will look after that itself?

MR. COX: I think it should.

MR. HARRIS: Recently, and this certainly is one of the main factors in movements of short-term funds because often the funds are not on a fully hedged basis and it have been rather interesting recently the way in which this has been handled. The Canadian banks in New York have been able to pay for deposits as high as 6-1/8 per cent because of the forward arrangements and at a time of the present outflow of short-term funds. Admittedly, they will come back after a certain period and things will change, but there are times when the market becomes very important in the movement of short-term funds.

COMMISSIONER GIBSON: You are suggesting that the Bank of Canada hasn't been active in the forward market?

MR. HARRIS: They have been recently, but they have found it difficult. I can't understand the reason for this, but I think they were of such a size and that it has become difficult to move in them at all just in the last month or two, but at times this forward market does have to be watched.

COMMISSIONER GIBSON: Are most of these short-term movements that you speak of hedged?

MR. HARRIS: Normally short-term investments in Canada, treasury bills and paper are hedged from the point of view of the work which the dealer does. There are, of course, foreign and central banks and I infer that anything the dealers do -- and we certainly see examples of fully hedged operations -- and other

people may employ the special deficits that they have over here.

MR. HUNTER: At the moment the rate has been moved forward to about $2\frac{1}{4}$ per cent per annum, which takes any initiative away from the Americans; it is too wide to let them profitably invest.

MR. HUNTER: The effect on commercial paper would be about $3\frac{1}{4}$.

COMMISSIONER GIBSON: You mean that it is encouraging the forward market?

MR. MILNER: Very definitely.

COMMISSIONER GIBSON: Are these large in your opinion, Mr.Harris?

MR. HARRIS: No, but they do cause a psychological effect to know that the market is going out, and the treasury board and the market I think on the whole are not ---

COMMISSIONER GIBSON: What sort of size is this?

MR. HARRIS: I did some research as far as I could into the amounts that the dealers are involved in in the New York banks, basically the New York banks, and I see in March of this year it looked like approximately 350 million were in these various types of investments. Now, the bills of sale on short loans, fully hedged loans in one year ---

COMMISSIONER GIBSON: This was money into Canada from the States?

MR. HARRIS: Yes, but it is just through the dealer operations; I have no idea how much will come in through the chartered banks that deal through New

York and elsewhere.

COMMISSIONER GIBSON: That is a pretty sizeable figure at one time.

MR. HARRIS: That was in March. At times it is over 500 million.

COMMISSIONER GIBSON: Coming in?

MR. HARRIS: That you have here fully hedged.

COMMISSIONER GIBSON: You say there is money that has moved the other way recently; is this the same kind of size?

MR. HARRIS: No, I don't think so although one has heard of quite good sized transactions but what it will amount to I don't know. This comes up a bit in papers payable by the chartered banks and other depositors where money is in the chartered banks, but most of this goes to the Canadian banks in terms of U.S. dollar deposits and the figure is of a substantial size. I think it would be above 100 million. I think in Canada it would be about 150 million, but this is the case.

COMMISSIONER GIBSON: This is highly valuable?

MR. HARRIS: Yes.

COMMISSIONER GIBSON: Therefore in a shorter period I take it it could be very significant in the market?

MR. HARRIS: Definitely because it can -- when Canadian money goes out it takes it away from the various banks and corporations and other people who have to pay higher rates and it creates more interest because of this.

COMMISSIONER GIBSON: Then you would, I take it, in talking about the spreads on interest rates between the two countries, and particularly in the short-term field, attach great importance to the future exchange market?

MR. HARRIS: Very definitely.

COMMISSIONER GIBSON: Do you consider this a subject that ought to engage the attention of the central bank?

MR. HARRIS: I think more than it does. I think quite a few of the dealers are in contact with the central bank and they know what is going on from day to day. Our firm and other firms telephone them in confidence, and they do know what is happening, and I think it is important this relationship be continued and that they are in close contact with what takes place.

COMMISSIONER GIBSON: Do you see this kind of business staying about the same, or growing, or what?

MR. HARRIS: I think growing. The dealers have been quite active in advising and talking to American corporations and American banks, and there is the cost of the fully hedged short-term investments and the interest rate differential, and this has grown rapidly in the last three or four years and I think it is an expanding operation. Another thing coming in is that the Canadian accounts are becoming more educated to putting money outside the country. At these higher rates it is very worthwhile to put money overseas into EURO-dollars.

COMMISSIONER GIBSON: Are these transactions sensitive to very small differences in rate?

MR. HARRIS: Yes.

COMMISSIONER GIBSON: You people make it your business to see they are -- or, some of the investment dealer firms?

MR. HARRIS: Certain investment firms follow this closely and one can move funds over to Europe very quickly. With Telex and the rest of it, it is a very sensitive and fast moving operation, and it has been growing.

COMMISSIONER GIBSON: Are there many firms engaged in this business in a serious way?

MR. HARRIS: No. I think they are growing all the time. It is a very marginal profit. It does lead to other business. You don't lose money, but you don't make very much; but it has a lot of indirect benefits.

COMMISSIONER GIBSON: Would they be mostly the larger national firms in this?

MR. HARRIS: Yes, only five firms or so that are actively in the overseas markets, but a number do sell in the United States.

COMMISSIONER GIBSON: And that would be much the bigger part?

MR. HARRIS: Yes.

MR. WADDS: There is nothing sentimental about short-term money. We don't worry about the B.C. Electric or anything. It goes where the rate is best.

COMMISSIONER GIBSON: That leads to the question

of longer term money and spreads. In B.51 you make reference to the proper spread:

"Basically, the interest rates in the United States and in Canada bear a definite relationship and since we in Canada operate in the dollar area, there is a substantial flow of capital between the two countries. This flow has the effect of arbitrage and tends to have what is regarded as a proper yield spread between the two markets, taking into account the yield obtainable in the comparable credits of the two markets and the level of our dollar in relation to the United States dollar."

Would you elaborate on the question of a proper yield spread? I take it you are talking about longer term bonds, are you -- securities?

MR. ELY: This is the one that I wrote, Mr. Gibson. There is a normal spread -- there has been over the years. When our dollar was at the same level as the American dollar, a half of one per cent spread between comparable securities seemed to be recognized as a normal spread between the two countries, and when those spreads widened or narrowed money flowed each way. When our dollar went to a premium you would expect that spread to widen.

COMMISSIONER GIBSON: Why -- on the grounds that the expectations would be that it would be go back to par?

MR. ELY: That is right, and when our dollar goes to a discount you would expect them to narrow.

COMMISSIONER GIBSON: For the same reason in reverse?

MR.ELY; That is exactly right, and that is the normal; but in the last few years, and more important in the last year, the normal has not existed because of the climate and the investor attitude towards this country. So that now you have rather a reverse situation where, comparing long-term United States Governments with Canadian Governments you have one and a half per cent in yield differential not even taking into account the deep discount at which our dollar is selling, and that should normally invite a tremendous inflow of capital to this country with the consequent narrowing of the spread. The opposite is happening because of the attitude of the American investor towards this country.

COMMISSIONER GIBSON: So we are getting what you describe as a perverse reaction?

MR. ELY: That is right.

COMMISSIONER GIBSON: Why should people expect, in the United States particularly, as a long-term expectation that our dollar should be at par? Your reasoning is based on that to quite a degree?

MR. ELY; Yes.

COMMISSIONER GIBSON: Do you think this is a fact, that they do so expect -- that they have such expectations?

MR. ELY: I think they do so expect. I don't know whether you can put your finger on the basic reasoning except that they are both dollars. Historically they move

either side, but there have been periods of premiums and discounts that sort of centres the thinking of their having some kind of a comparable value.

COMMISSIONER GIBSON: But now you feel that the Americans have got over this fixation, do you?

MR. ELY: The market indicates it.

COMMISSIONER GIBSON: In other words, what you are saying is that if things were as they should be, the spread at present exchange rates would be a narrow one -- half of one per cent or less?

MR. ELY: If the American investor -- and that is the man we are talking about, putting his money in this country -- if his view was that our country was being run properly he would come in in very big volume at these levels, but he has not.

COMMISSIONER GIBSON: Do you think there is a danger that he may change his mind one of these days and send in more money than we want to receive again?

MR. ELY: There is. There is a very definite danger. It won't be apparent to most people when it starts. If the policies which have been recently adopted start to work and we conduct ourselves in such a way that we repay or start to repay the short-term credits which we have been given, there could start a very big flow of money from the States to Canada.

COMMISSIONER GIBSON: And maybe you would be in favour of government deficits at that point?

MR. ELY: No, I am never in favour of government deficits. I think we all agree, and we have agreed in this brief, that there are times for deficits and

surpluses. What we do not agree with was that during the last few years we should incur deficits which built our debt up from some 15 billion to 19 billion. This is far too great, and the investor in foreign countries is telling us that by not putting his money in and, in fact, drawing it out.

MR. MILNER: I think I might add, I think our central bank here is rather fearful of a permanent fixed exchange rate just for the reason Mr. Ely points out. In the 10 or 12 or 20-year period, whenever the date was that we unfroze the dollar or put it on a floating basis, the rate of premium was what cut the American money coming here -- the unwanted American money. After all, we are living with a country to the south of us 10 or 15 times our size, and the movement of funds from the United States to Canada can be very detrimental to our economy if it becomes too great or too little, and with the floating rate it was far easier to regulate that flow. As Mr. Ely points out, if this economy or austerity programme works here now, I quite agree we could have a very large flow, an embarrassingly large flow of American money into this country with a fixed exchange rate. Whether the exchange rate could be adjusted to take care of it I would not care to comment.

MR. ELY: It could start very active dealing in the forward exchange rate to slow it down if we see it coming too fast.

COMMISSIONER GIBSON: This must put some of you gentlemen in a very difficult position in advising

clients -- U.S. clients, and Canadian clients with U.S. funds. What would you say today in these circumstances? The picture as you present it is highly favourable for moving American dollars into Canadian long-term securities.

MR. ELY: As far as rates are concerned?

COMMISSIONER GIBSON: Yes, all the mechanical calculations suggest it is very good.

MR. ELY; That is right.

COMMISSIONER GIBSON: You must have a lot of trouble in making up your minds about what sort of advice to give.

MR. ELY: To American investors?

COMMISSIONER GIBSON: Or to Canadians who own American funds.

MR. COX: I would agree with that.

COMMISSIONER GIBSON: Because, in effect, you have got to assess this American opinion, or external opinion of Canada against a statistical opinion?

MR. MILNER: But surely, Mr. Gibson, it is too early yet to see whether -- I think your foreign investor quite naturally today said, "Let us wait for six or seven months" -- or whatever period of time he wants, to see how this new programme might work in Canada.

COMMISSIONER GIBSON: I am not expressing a view. I am asking for yours.

MR. ELY: Statistically we should be recommending to foreign investors that they put their money in this country, basically looking at the exchange rate and the differential in rates -- and we are trying

to do that all the time -- but they appear reluctant because of other factors.

COMMISSIONER GIBSON: One day when and as this programme takes it will all start swinging the other way?

MR. ELY: We could have a very embarrassing flow, and that is the time they will probably have to change the level of the peg or maybe free it to stop it before it gets too embarrassing.

COMMISSIONER GIBSON: As we did in 1950?

MR. ELY: That is right.

COMMISSIONER BROWN: Or operate on surpluses and have very little interest. We realize this brief was prepared by committees and therefore there will from time to time be differences of opinion come up, and Mr. Ely just commented on what he has written in this respect in B.51. I wonder if we could have the author of F.30 comment on his statement that it does not seem likely that any regular spread in rates between the two markets can be established.

MR. HUNTER: If you refer to pages 15 and 16 we have graphs there showing differential through the years 1959, 1960, 1961 and part of 1962 on comparable short-term U.S. and Canadian bonds, and in the long-term area you can see where the spread widens out: In one area as much as 1.71 and back to 1½. Recently it has been down about 80 basis points, prior to two months; about 80 basis points. I agree with what Mr. Ely says, that 50 basis points used to be regarded as the normal spread but that really has not existed for some

years now, and I think that there are so many psychological factors that enter into what the American investor does and thinks -- his own market, whether the rates are good there without coming into Canada -- and , as I said earlier, the stability of our exchange rate for a given period -- it is probably a very practical thing. Most of the investors in Canadian securities are institutional company people. They do not like to make an investment today and find the rate changes 2 per cent by the time they report to their board.

COMMISSIONER BROWN: But your point is that this stability, looking at the chart on page 16 -- the changes that occurred after this chart was made when the spread suddenly widened from about 85 ---

MR. HUNTER: To 1.50 again.

COMMISSIONER BROWN: Yes, that this crisis with respect to the foreign investors' attitude towards the Canadian market has occurred only in the last three or four months?

MR. HUNTER: You mean his desire to buy Canadian securities?

COMMISSIONER BROWN: The crisis that has caused the widening. If you expand the graphs to the last two months, it is much wider.

MR. HUNTER: I don't think the American investor has anything to do with it. In this instance the American market has held fairly constant, and the Canadian market has adjusted itself because of austerity measures. In the meantime the American investor has been sitting on the sidelines until in the last few days

there has been some indication he is taking an interest again.

MR. COX: I think that half of one per cent Mr. Ely refers to is the outgrowth of the fact Canada financed its war effort at 3 per cent and the United States at $2\frac{1}{2}$.

COMMISSIONER GIBSON: But the spread here, as Mr. Ely emphasized, I take it is not just a spread in interest rates. It is the expectation of lower exchange rates as well.

MR. HUNTER: The exchange rate is really the important thing. Why do the Americans think our dollar is going to be at par with theirs? It has happened. Anybody that has bought a security in the last 20 years has had an opportunity to get out at par, and psychologically he thinks this is going to happen again some day. Maybe he is right.

MR. MILNER: There is one point which might be brought out at this moment. This goes back to withholding taxes. Rightly or wrongly the American investor who is fully taxable -- in other words, take a pension fund type of investor, where they are tax free in their own country: There is no rate of exchange at which they will buy Canadian securities with a withholding tax, because they argue that whatever rate they buy it at is 15 per cent wrong because they are paying a premium for something they don't get.

And that is a very big factor to contend with. If the withholding tax were completely removed you would open up a very, very large old field of money that would flow into this country.

COMMISSIONER BROWN: Is this a factor in the long term Canada market?

MR. MILNER: In both.

COMMISSIONER BROWN: Most of the long term Canadas were issued prior to December 20th?

MR. MILNER: The purchasing of some or the re-investment of some funds has been completely stopped or practically completely stopped by just that peculiar factor.

MR. WADDS: I would say this, too, it is a bigger factor in provincials than otherwise. This is a trade secret I am letting out.

MR. HUNTER: We have not had a new Canada long term issue for such a long time that I really do not know what the true rate on long term Canadas is at the moment. It is somewhat artificial due to the activities of the purchase prices, et cetera. There have been lots of sellers but few buyers. If we have an issue of Canadas on long term probably we will get down to some realistic knowledge on what it should be.

MR. ELY: There is another factor that comes into the picture. The state pension fund in the United States amounts to $36 billion and they are normally buyers of Canadian securities. Since they are subject to the 15 per cent withholding tax

they have not been buyers. That should make a tremendous difference in inflow from that area alone.

COMMISSIONER GIBSON: The other question I wanted to raise about the spreads was the point we were getting along into, the spread between Canadian federal and United States federal bonds and long term corporate bonds. I understand if you do this the spread is a little closer than it is in long term governments or has been up until recently, is that correct?

MR. COX: Yes, I believe it is. I have been keeping track of yield spreads on double and triple A utilities in the United States on things like, say, Ontario Hydros and the spread has been a little narrow.

COMMISSIONER GIBSON: This is some real comparison because there is a big market on both sides of the border?

MR. COX: It is a field in which the American buyer is interested. He prefers our Ontario Hydros to some high grade utilities in his own market.

COMMISSIONER LEMAN: Mr. Gibson, I would like to get one point clarified here. You are not suggesting that the 15 per cent withholding tax on Canadian pay issues held by non-residents be removed, are you?

MR.WADDS: Yes, we are suggesting that all withholding tax on Canadian securities be removed.

COMMISSIONER LEMAN: We have not had that

for years.

MR. WADDS: Yes, we had it on Canadian government bonds. We had a 5 per cent tax on provincials, 15 per cent on corporates.

MR. MILNER: Actually, Mr. Leman, I think the way, the solution to the withholding tax is to revise the whole subject and that is what we are submitting in our brief. There are some rather peculiar analogies in that withholding tax. Probably the right thing to do would be to start afresh. It comes under the tax agreement between the two countries. We had up until December of last year external payment Canadian bonds free of withholding tax.

COMMISSIONER LEMAN: That is what I wanted to get straight. On U.S. pay bonds that is a different matter. On Canadian pay bonds I could not understand what your recommendation was.

MR. WADDS: The chief point we are trying to get at here is to put a withholding tax on any Canadian serviced external or internal bond you are affecting the flow of American dollars in the long run out of this country and if we are interested in financing our debt then these impediments to free movement of capital into this type of debt should be removed.

COMMISSIONER LEMAN: But if you buy a U.S. pay bond in the States you would have 15 per cent withheld against you?

MR. WADDS: That is right.

MR. HUNTER: I think it is more desirable even on some internal Canadian securities in the United

States than it is on external securities. It takes the responsibility for the exchange away from the borrower and the interest payments et cetera are not then subject to fluctuations of the Canadian dollar.

MR. WADDS: A municipality that can finance through Canadian pay securities and sell it in the United States has developed no exchange liability for itself and this can be very onerous in certain cases. They are to certain municipalities that have borrowed in United States dollars.

COMMISSIONER BROWN: One point I would like to clarify and that is: Is it not correct on a long term bond that was issued prior to the re-establishment of the 15 per cent withholding tax December 20th, 1960, for example, that conversion has been free, that there is no withholding tax on those even now?

MR. SHAW: The exemption from the withholding tax still applies.

MR. COX: I wanted to clarify this point --

MR. HUNTER: This is still a psychological barrier as even those free of tax they do not like paying tax to a foreign government and therefore they sort of frown on our whole operation.

COMMISSIONER BROWN: Even though there is no tax on those particular ones?

MR. HUNTER: Even though there is no tax on those particular ones.

COMMISSIONER BROWN: There is a psychological

condition, is there?

MR. WADDS: That is precisely it.

COMMISSIONER BROWN: Let us take it up psychologically.

COMMISSIONER MACKINTOSH: It seems to me one thing is being sort of submerged here in the discussion on taxes. It apparently was the view in imposing withholding taxes that we did not need this American capital. All representations here seem to be that we do need inflow of American capital.

MR. SHAW: We are fairly consistent in that view. We did not share the concern that was not so apparent for a while.

COMMISSIONER MACKINTOSH: I think we are getting to a point where it ought to be brought out.

MR. MILNER: But, Dr. Mackintosh, the reasons, I believe, for changing withholding tax or deleting the advantages of withholding tax were put on to discourage -- they were not put on to discourage investment to the extent that they were put on to effect the exchange rate when the government at the same time made the announcement they intended to depreciate the Canadian dollar from a premium.

COMMISSIONER MACKINTOSH: What was supporting the Canadian dollar?

MR. MILNER: The flow of funds.

COMMISSIONER MACKINTOSH: Well, I take it I am entitled to think then they wished to discourage the inflow of funds?

MR. MILNER: They succeeded admirably.

COMMISSIONER MACKINTOSH: The point I want to make clear is that you people say the flow of funds to the United States cannot possibly end.

MR. HARRIS: Actually in December 1960 for the previous quarter, at that time there was not a net inflow, it was pretty well averaged because of repayment of insurance securities. This was not -- because of the concern that had been built up in the press and various speeches, this was not really considered as serious as it should have been at the time. The statistics were there but this was not a problem actually in December of 1960.

COMMISSIONER MACKINTOSH: Well, in many instances the government is a little late in getting around to it.

COMMISSIONER LEMAN: Just one little point following on this. We are talking about various times here. At this time forget about the deficit that Canada is still running. Is the level of investment here in Canada that we do need external capital to finance it?

MR. SHAW: The demand for investment funds is made up both of need for investment capital and need for money to finance deficits; in other words, the demand for investment funds is very heavy in Canada.

COMMISSIONER LEMAN: What I would like to understand more clearly is whether what you would be aiming for now is to get back the funds that have flowed out over the period?

MR. SHAW: That is the first step.

COMMISSIONER LEMAN: And beyond that?

MR. MILNER: Well, Mr. Leman, this conversation has all been confined in relation to the federal situation only. You have to add to that that not only has the federal government spent a lot of money but all governments in Canada spend a lot of money. Provincial borrowings have been fantastically high over the past ten or fifteen years and it really goes down right into the municipal level. So when you look at the payment problem or the interest in having outside capital it is not only at the federal government level; it is at all levels of government that need capital and I think it would be fair to say that if we are going to keep on at the present rate of governmentals' spending that we will need outside capital in order to procure the funds.

MR. ELY: I think what you asked, Commissioner Ely, the first and most pressing problem is to conduct ourselves in such a way that we regain our recent losses and put the exchange fund back to the position it was in where we have a proper level of reserves. Beyond that we will certainly need money in this country if we continue to expand. I would not think, referring to a question that Mr. Gibson asked quite a bit earlier, we would not need it in the same volume that it was coming in in the 1950's.

COMMISSIONER GIBSON: I would like to return to this question of the spread. I am sorry to be so insistent but when we talk about United States

government and Canadian government spread, I think it was said that the utilities spread was more important in recent times and I wondered if you could give us some idea how big this spread has been recently between securities of which there is a volume?

MR. BEATTY: 1.65 per cent at the moment.

COMMISSIONER GIBSON: That would be between what?

MR. BEATTY: Between the most recent high grade utilities that were sold at tender in the United States and the recent Quebec issue.

COMMISSIONER GIBSON: What is a reasonable spread there? Would you take your one-half of one per cent, Mr. Beatty, as being a sort of normal?

MR. ELY: No, on balance you might take it maybe narrower than one-half of one per cent, the dollar being at a discount.

COMMISSIONER GIBSON: Supposing the dollar is at par -- one-half of one per cent?

MR. ELY: It used to be one-half. I would think it would be wider than one-half now because of the investment attitude of the foreign investor.

MR. COX: I think it has been in the range of 80 cents to $1.

COMMISSIONER GIBSON: My impression has been three-quarters.

MR. MILNER: Three-quarters is about the figure I would have given, Mr. Gibson.

COMMISSIONER GIBSON: So that the spread there has actually been narrower than from looking at

these charts?

MR. MILNER: Yes.

THE CHAIRMAN: Adjourn for ten minutes.

(At this point a short recess was taken.)

THE CHAIRMAN: We will now resume.

COMMISSIONER BROWN: In section B, paragraph 8, there is a reference to inflationary tendencies. I would just like to ask you for your opinion as to the present force of these inflationary tendencies.

MR. ELY: In that section, Mr. Brown, I was really referring to what had happened and, having happened, why there were certain attitudes taken towards long term bonds. I think the inflationary forces are not in the economy today at all.

Do you want any further comment in that regard?

COMMISSIONER BROWN: No, that is what we wanted because there was the implication that unless they are checked this investment direction was going to continue to decline.

MR. ELY: I think they have checked themselves.

COMMISSIONER BROWN: What do you think of the future?

MR. ELY: Well, inflationary forces in a country turn investors to other types of securities, obviously, than fixed income securities.

In the foreseeable future I do not think there is much danger in this area, but we should always be watching for it.

MR. COX: Mr. Brown, I have here a copy of a brief that was presented by the Association before the Senate hearings on inflation. I do not know if the Commission would like to have it or not.

It is quite authentic because one of the authors was the Secretary of the Commission.

COMMISSIONER GIBSON: Is it up to date reflecting your present views?

COMMISSIONER LEMAN: If so, it is probably available to the Commission.

MR. SHAW: Perhaps.

COMMISSIONER GIBSON: To go to a new area -- now in respect of monetary policy and debt management, your second recommendation suggests that we consider separation of the control of the currency from debt management. You say: that the Commission examine areas of conflict between debt management and control of currency with a view to determining whether these functions should be separated.

We live with a sort of permanent problem of trying to reach workable compromises between the interests of debt management and the interests of monetary policy. Your presentation brings this out very clearly, because in section B, paragraph 14 you suggest that debt management has been unduly subordinated to monetary policy at times, and in section C, paragraph 8, you say that monetary policy is in fact being pushed around by debt management.

I am not reproaching you for this apparent conflict because I do not think it is a conflict. I think this is in the nature of things; that debt management and monetary policy are always trying to work out reasonable compromises between the basic objectives,

and that this is more or less in the nature of control in any modern society. You later suggest that debt management should become directly under the control of the Department of Finance. Would you elaborate on this as to how you think it will help to solve co-ordination of debt management policy and monetary policy?

MR. MILNER: Mr. Gibson, before answering that I might bring to the Commission's attention that we have divergencies of views among ourselves as to the right approach to this thing. I am going to ask Mr. Ely, if I may, to start this, and Mr. Cox to comment on it later.

MR. ELY: Mr. Gibson, you are talking about paragraphs 14 and 15 in Section B?

COMMISSIONER GIBSON: Right.

MR. ELY: If you go to the latter part of paragraph 15 of section B you will note that I say: if that management were taken back to the Department of Finance it would have the effect of bringing the Department of Finance and the Cabinet into closer association with the problems of raising money in the capital markets to implement government fiscal policies, which do not now adequately seem to reflect the requirements of sound judgment.

I think in this particular portion of the brief the whole approach was to get the problem closer to the people who were creating it so there would be a greater understanding of the problem of raising money.

COMMISSIONER GIBSON: By doing this, of course, you take the problem further away from the body responsible for monetary policy. You still have the problem of coordinating monetary policy and debt management. How would you meet that?

MR. ELY: I think it would be met more or less in the same way that it is met now, because the Bank of Canada would be the advisor and there would have to be complete and close collaboration between the Bank of Canada and the finance department. We understand that that is going on now in a pretty satisfactory manner.

COMMISSIONER GIBSON: If the Bank of Canada is the advisor, will it also be the operator?

MR. ELY: I think the Department of Finance might even ask the Bank of Canada to be the operator until they can staff the Department of Finance with the kind of people who can handle it. There is very close collaboration between the two, and there should be, but the fundamental approach is still that if you take it to the Department of Finance you then bring it closer to the people who are creating the problem.

COMMISSIONER GIBSON: But you still have to have coordination?

MR. ELY: Always.

COMMISSIONER GIBSON: And are you going to have two groups of people operating the security market with ultimately the bank on the one hand the Department of Finance on the other?

MR. ELY: I think eventually you can only have one group operating it so that you leave then the Bank of Canada in charge of monetary policy and the Department of Finance in charge of debt management in its entirety.

COMMISSIONER GIBSON: But then you get the two inextricably muddled up at the security purchase and selling level, and the one effects the other, in other words?

MR. ELY: That is right. I think that on the secondary marketing operation, rather than the primary operation, it would have to be carried on by the bank, but when it came to the primary operations they would be conducted by the Finance Department.

COMMISSIONER GIBSON: The primary operations; you mean quotations on new issues and refundings?

MR. ELY: New issues and refundings.

MR. MILNER: I would like to have Mr. Cox speak on this as well.

MR. COX: I think the feelings in section C were similar to those expressed by Mr. Ely. We have a comparison which perhaps is not necessarily valid because situations are different from one country to another. We have in the United States a federal reserve operating the monetary policy and we have the treasury doing debt management. It seems to work relatively well.

I think there is also the aspect that the Bank of Canada is now being asked to do too much. If

the bank were in a position to devote itself to a greater extent to monetary policy problems, and the Cabinet were made more aware of the difficulties that their fiscal policy might create on the capital markets, this might be a step in the right direction.

COMMISSIONER GIBSON: Yes, but the problem that I do not quite understand is that you are going to have two people operating in the security market more or less parallel to each other, are you? Is it your thinking that by having what you might call an investment department within the Department of Finance, with the added skills and abilities there, it would be beneficial to the operation of both debt management and monetary policy?

MR. COX: Yes, I believe that. I think you also have to bring in fiscal policy. Debt management arises in many instances, or the province of debt management arises from fiscal policy.

COMMISSIONER GIBSON: Yes, but you see the Bank of Canada now is the agent of the Department of Finance in debt management.

MR. COX: Yes.

COMMISSIONER GIBSON: Unless you build up an operating department in the Department of Finance there really is not much difference between the situation that exists now and what would exist in the future.

MR. COX: I think we envisage a complete department as they had prior to the Bank of Canada to look after debt management in the Department of Finance.

COMMISSIONER GIBSON: And how do you get co-ordination between the two investment organizations?

MR. COX: By liaison of the very highest degree, of course.

COMMISSIONER GIBSON: You do not think it is better to have one investment department with the finance department then in the position to state what policy is now in debt management? It is its basic responsibility.

MR. WADDS: There is no question as to whether that would result over a period of time.

COMMISSIONER GIBSON: This is, you say, the underlying constitutional effect?

MR. WADDS: Yes.

MR. MILNER: Under existing circumstances in the last few years there have been many instances where the central bank has been running both ways at the same time. It has been operating for the debt management in one term and from a banking viewpoint as the central bank in another viewpoint. They are converse; completely different objectives in both cases. We had in mind that if you reverted to the pre Bank of Canada situation where the Department of Finance was responsible for debt management and the Bank of Canada responsible for monetary policy you would not have that conflict, and you would have a much clearer picture before the public. We are not unanimous at all in this view and possibly the fault might be remedied in another way. Unfortunately what has happened in the past number of years is that

the Bank of Canada has become sellers of securities, let us say, not for their own account, but for the government account, but the general public has not been aware of who they were selling for, and before we knew it we had a situation where we had a rising or falling market caused by a cause which was not correct. It was not monetary policy, it was merely that they were selling for a government fund.

COMMISSIONER GIBSON: But you see, you approach this problem, and I have it in mind even more, by saying that the bank is trying to go in two directions at the same time. How do you get around that? Putting debt management under the Department of Finance does not avoid this basic conflict. If considerations of that management are to do one thing and monetary policy to do another, there is still the conflict. It still has to be resolved. Somebody has to work it out. I think if you propose this sort of thing you ought to show how these conflicts can be worked out. Liaison is one thing but how do you get this liaison? The Department of Finance is now in a position to state what the policy is in respect to debt management.

MR.MILNER: Mr. Cox, would you like to go on in that regard?

MR. COX: I think it gets back to the question that the department is looking after debt management. Its influence with the government is going to be considerably greater in the department's fiscal policy.

COMMISSIONER GIBSON: You are really saying,

if the Department of Finance were closer to this their fiscal policy might be affected in what you would regard as a constructive way, is that right?

MR. COX: Yes.

MR. ELY: That is correct.

COMMISSIONER GIBSON: I do not think you have answered the question as to how you would do this in an operative way. You cannot escape these conflicts; they are inherent in our society.

MR. COX: But we hope the conflicts will be less dangerous and there will be greater harmony between the three items of fiscal policy, debt management and monetary policy.

COMMISSIONER GIBSON: Mr. Milner, you say you do not all agree on this subject. Would some of the people who do not agree care to say something?

MR. MILNER: Just as you are saying, Mr. Gibson, some of us feel it is almost impossible to separate the two and have them operating. I think Mr. Harris has got something he might wish to say in this regard.

MR. HARRIS: I tend to agree with Mr. Gibson, I think.

COMMISSIONER GIBSON: I have not expressed a view.

MR. HARRIS: Well, you expressed it perhaps indirectly. We have had pretty unusual times during the cental bank history in this country. We have had unusual circumstances within the bank and within the government. In the long run I think you

would be creating a problem by putting it in two places. You may create more political problems possibly in the long run. I think at the moment it may be attractive from our point of view where we have lacked direction. We have found it, as dealers, a difficult thing under certain conditions. I can see more problems over a longer period perhaps if things were split in this way.

Surely the bank is, as you say, the advisor and agent of the Department of Finance. Perhaps one problem is that the Department of Finance until fairly recently has not taken as active a role as it should have in looking at the capital markets. It has not had the people. I think this has been corrected. They are taking a more active role in studying markets and studying the effect of issues upon the markets. This has perhaps been the problem in the past. I think it is improving now. I think it is fully aware of this problem and taking a much more active role in policy.

MR. ELY: Mr. Gibson, I was one who was not completely in accord although we held a discussion last night and I think we tried to resolve our differences.

The reason I was not in accord was that I felt that taking debt management out of a non-political body and putting it into a quasi-political body might possibly mean that it would be run along more political lines which would be wrong in our opinion. I wanted to separate the political approach by leaving

the whole thing with the Bank of Canada as a non-political operating body.

We felt that the argument was outweighed on the side of getting the problem closer to the people who created it.

COMMISSIONER LEMAN: You would not suggest that the government should go and ask the bank how much money it will let it have to carry out policy?

MR. ELY: The government is all powerful and when the chips are down it tells the bank how much money it wants, there is no asking.

COMMISSIONER MACKINTOSH: This is a point I think we ought to clarify. The present arrangement is that the Minister of Finance is the principal and the Bank of Canada is the agent.

MR. ELY: That is right, sir.

COMMISSIONER MACKINTOSH: My understanding is that the Bank of Canada always makes clear in its transactions whether it is acting as agent or acting as principal on its own account. I do not know how the public gets this confused view that they are acting in different ways, but I should think the only information the public had would come later when the accounts come in. Certainly it does not show up in the Bank of Canada accounts in respect to unemployment insurance, but that would show up in the unemployment insurance fund later.

MR. SHAW: The difficulty, Mr. Mackintosh, is that we are talking about the public. I think we were referring to our traders and people who are

clearing on day to day transactions, and the bank does not tell us why they are doing these things. It is left to us to infer what is behind these purchases or sales. Sometimes we are led to the wrong conclusion in talking to the same fellow on the telephone when he is selling or buying, and we attach a significance to it which is incorrect. He is not doing it from a monetary policy point of view, he is doing it because he has instructions as an agent to carry out some particular job.

COMMISSIONER MACKINTOSH: My understanding is that he tells you he is acting in one capacity or the other.

MR. SHAW: Unfortunately he does not, sir.

MR. ELY: He does not tell us.

MR. MILNER: Mr. Harris may wish to answer that.

MR. HARRIS: I think very often there are occasions when they state they are acting on an account, but I believe there are many times when transactions are done and they are reluctant to indicate that. It may be that a trader in Toronto or Montreal does not really know at the time.

COMMISSIONER LEMAN: Perhaps he should ask if he is not told.

MR. HUNTER: I mean, the bank trader has to be told by Ottawa.

COMMISSIONER MACKINTOSH: Is this a continuing variation in procedure? Our understanding is that there are traders who are always informed.

MR. MILNER: There is probably no one ---

COMMISSIONER MACKINTOSH: Your experience is that they are not?

MR.HUNTER: I do not think there is an active trader here, but it is my understanding that we are frequently at sea whether it is for monetary policy or against.

MR. MILNER: Would you like to answer that, Mr. Cox?

MR. COX: Our troubles have been told on occasion, but I would not like to leave the impression they say they are acting for an account.

COMMISSIONER MACKINTOSH: You say they do not invariably say it?

MR. COX: Very definitely they do not invariably, contrary to what their brief suggests.

COMMISSIONER BROWN: They also confirm the ticket and it makes it quite clear they are acting for another account. Of course, you do not get that?

MR. COX: No, and I do not know that very many of us see the tickets.

MR. SHAW: It would be far better to do so -- the method of operation, is it not true, is that the only way we can find out what the bank is doing is to go to them and they very, very rarely initiate an interest.

Am I right in that, if you want to find out what the bank is doing you try them out on a bid and they accept it or not.

COMMISSIONER MACKINTOSH: Is not that the way you usually find out how the market is doing?

MR. SHAW: That is right, but in the circumstances is it not quite possible there would be no further conversation and then you try them out with another block and see how far they are prepared to go. It is a fair trade operation without too much conversation as to why the operation.

MR.HUNTER: One of the problems is that the Bank of Canada is the major factor on the market and every known bond trader or institution that deals actively in securities will take no action, even in the provincials or other securities, he wants to know what the Bank of Canada is going to do, and this is such a focal point that if a dealer thinks that the bank is meeting a certain price for bonds they will offer bonds to find out if it is. If not, they will offer them down, which starts a deluge of selling which might not have occurred if the bank had not been in the picture at all.

COMMISSIONER GIBSON: To change the subject for the moment; another very important statement in section C, paragraph 28, is the statement which comes out in favour of the "preferably" policy for the Bank of Canada open market operation. The Asspciation does not make this recommendation although it is contained in Section C; the view is expressed it is

desirable in Section C. Would you care to comment on that?

MR. COX: Well, you accept the concept that when the bank wants to buy securities they want to deal with the reserve of the chartered banks and it can be done just as effectively in a treasury bill and it can be done with less destruction of the market because it is done under the shorter term segment than under the longer term segment and you get higher points in yield -- I think it is one cent in price and one-half a point on a twenty year bond, and if you operate in the long segment of the market you are liable to create an artificial level, which has several weakening effects on the strength of the actual level where the market should be. I am not expressing this very well.

COMMISSIONER GIBSON: I think you are making your point reasonbly clear.

MR. COX: And the best digest I have seen on this subject is by Winfield Riefler, published in the 1958 Federal Reserve Book and there are several quotes in one of the paragraphs here in Section C.

COMMISSIONER GIBSON: But you make this -- I would not say"recommendation" -- about the bills of the short market operation and the Association does not recommend this. Do you disagree on this point or is the Association in agreement with Mr. Cox's view or the statement given in Section C.

MR. ELY: I think, Mr. Gibson, that you must recognize that there are 197 members of the

Association and there are only 14 money market dealers who have any real knowledge of this subject, and even amongst the 14 money market dealers there might be only a percentage of them who would be experts, so it would be very difficult to get the broad agreement of the Association on something that involves only a very few houses.

COMMISSIONER GIBSON: This is the reason you have not given it as an Association recommendation; not that you disagree, but it would take people who are experts.

MR. ELY: That is right. At our session at Lucerne on this subject we are talking about there were really very few people who had any views on it at all.

COMMISSIONER GIBSON: It is not out of harmony with some of the banks' views. Perhaps you might refer to the central bank's brief, Mr. Cox; I glanced over it and they said they are in favour of that policy in general. Are there any comments you would like to make?

MR. COX: We suggest there are occasions when it might be helpful for the central banks to operate on a longer term basis. This would be on the conditions that the market becomes disorderly or ----

COMMISSIONER GIBSON: You are not finding disorder!

MR. COX: It is very difficult to trade, and where trades tend to take place at considerable

changes in price and there is little continuity to it and the volume has declined because of the difficulty with trading, and it would be opposite to the broad resiliant type of market that is considered desirable.

COMMISSIONER GIBSON: You believe there are circumstances such as the very recent one where the central bank should be in the market?

MR. COX: I think they should be stabilizing to some extent; not necessarily ordering the direction of the trend of the market, but stabilizing it so that some trade can take place, and this is something that is very well dealt with in several federal reserve conflicts and they have a similar view in the States that a disorderly market should not be allowed to exist because it creates a great deal of apprehension and since the government market is the central point around which all other interest rates fluctuate, it effects all other types of credit and all other types of borrowing.

COMMISSIONER MACKINTOSH: Should they "prepare a good reception" for the issue?

MR. COX: I think they have been known to.

MR. HUNTER: The Bank of Canada has been using this purchase fund operation to help stabilize the market for the past several weeks and it has eased things down a bit.

COMMISSIONER GIBSON: So when the variations become large the spreads become wide; that is the

case that the central banks make out?

MR. COX: I think we should keep the apprehension at a minimum rather than emphasizing it.

COMMISSIONER GIBSON: I hear from what you might call die-hard individuals who say they would rather not have a long market in any circumstances; if everybody knew they were not there at all you would get a better market ultimately. Is there anything in that?

MR. HUNTER: Yes, I think there is something in that; this disorderly thing is ---

COMMISSIONER GIBSON: You would have to put it with disorder if you accepted that?

MR. HUNTER: You would have to, yes, but I think this is sufficiently important because the effects of rapid changes in yields of Canadian bonds affects yields of other securities to quite a considerable extent.

As a matter of fact, there are some figures here which I might leave with you. In the past two years, from June 1960 to June 1962 there have been six important changes in the direction of the yields, and despite the fact that there was only one long -- it was actually a C.N.R. issue in the fall of 1960, and since then there has not been any long issues at all. The total change on yields in that period -- and this is based upon an average of yields for each month -- the total change on yields on Canadian is 1.67 per cent, whereas on provincials -- where there has been a tremendous amount of operating change -- it is only

1.46 per cent. In other words, Canada is 15 per cent more than the provincials, although the government has refrained from operating in that field.

COMMISSIONER GIBSON: How does this bear on the business deals, only occasional intervention?

MR.HUNTER: I think it is the fact they have been intervening in the long market that caused these wider fluctuations.

COMMISSIONER GIBSON: Is it not a fact that this has had something to do with their being able to support the market in recent years?

MR. HUNTER: Well yes, I think that has been their endeavour; whether they have succeeded in doing this is a question that might be debated.

COMMISSIONER GIBSON: But you are almost saying that the fact that they are known to be intervening at times is a disturbing element on the market.

MR. HUNTER: It becomes -- I do not know that these price levels are exactly right because I am working from memory here, but the purchase fund was at 83 earlier this year and the market is in the range of 91 and 92, and the market then moved up to the 94 range, and as far as we know the bank did not raise its purchase fund until they all of a sudden moved it up two points and got it up to the trading level of the market again. Then it went down, and maybe the bank actually had an instruction from the Department of Finance to take so many bonds at 94, and they took them, and then had to keep shooting it

down the market as fast as they could.

COMMISSIONER GIBSON: Your other members more or less agree with the view that there are times when the Bank of Canada should enter the market?

MR. MILNER: The Bank of Canada entered the long term market in a very large way and the fact of the Bank of Canada owning such a tremendous amount of long term debt, in our opinion, has had a very deterring effect on the long term Canada market ever since because you always have the overhanging viewpoint that if the market were to go up it could absorb a huge amount of the Bank of Canada's holdings and that the Bank of Canada would love to be rid of their debt and operate as a bank in the immediate and short term fields, so that this is where we have disagreement amongst ourselves. There have been suggestions, for instance, which were made -- it was considered as a suggestion that the Bank of Canada might freeze its long term Canada position to get rid of the fact that that was always overhanging the market and if there were no long term securities held by the Bank of Canada -- not the government of Canada but the Bank of Canada -- I think we would have a much more realistic open market in long term investment; I think it would be a much broader margin than exists today.

COMMISSIONER GIBSON: You are not altogether agreeing with Mr. Cox; he said there were circumstances when the Bank of Canada should prevent disorderly

conditions, and you think it would be better if they did not intervene at all in the long market?

MR. MILNER: I think, Mr. Gibson, that my conception of disorderly conditions might be different from some of the other committee, but my conception of a disorderly condition applies both ways; you can have a disorderly market going up as well as one going down and there have been two or three occasions when we have had a disorderly market on the reverse end; that is, too quick a rise ---

COMMISSIONER MACKINTOSH: You want them to intervene on both sides?

MR. MILNER: I think the function of the Bank of Canada -- this is my personal view -- I think the function of the Bank of Canada primarily is to attempt to stop excess movements of markets which are not in accordance with governmental policy, and that would apply both ways.

MR. COX: If you want it to apply both ways. I used the example of the declining market.

COMMISSIONER GIBSON: This raises all kinds of problems because you say you are in favour of bills preferably, but if the conditions are disorderly in either direction it may mean that the central bank should intervene. I do not know how you can define "disorderly" in this sort of way.

MR. HUNTER: Maybe the advantage to having a Canadian market is that it could be the Department of Finance who intervenes in a disorderly market.

COMMISSIONER GIBSON: This gets back to the conflict between management and the policy -- if they are doing something which is in conflict with the Bank of Canada, it is still being done and has to be co-ordinated.

MR. HUNTER: I think the action of the Bank of Canada in the recent applications has been largely on behalf of the Federal government for a purchase fund. I do not think that the Bank of Canada is in the wrong end of the market -- at least, I do not know.

COMMISSIONER BROWN: They have been buyers and not sellers.

MR. HUNTER: We have been sellers recently, but we do not know.

COMMISSIONER GIBSON: Let us put it another way. We have a modern type of free enterprise society and in this kind of society the dealer has to carry a fair load. Should you give the authorities the responsibility of sustaining the bond market or, indeed, from preventing it from going up too high with very strongpressures the other way; you are in effect trying to moderate the changes in existing rates that occur from time to time and which are part of the machinery for trying to check the boom or stimulate the recovery. Do you want to moderate the changes?

MR. MILNER: We want to smooth out the excessive movements either on the upside or the downside. My conception of the way, for instance, the exchange fund operated over the past five years was trying to smooth out -- they didn't try to force a rate either way. They merely prevented it from going too far either on the up or the down side, as the case may be, too quickly. On the governmental long-term bond market you have got an exactly similar situation, that if the dealers, which is our industry, misjudge a market to the extent of driving prices up too fast by accumulating a huge inventory position, it is probably not in the best monetary interests or fiscal interests of the country, and it is very easily stopped by the Bank of Canada, either on the government account or its own account, moderating that upswing. But the main objection, I think I am right in saying, we have had over the past five or six years has been that on the downswings we rather question whether the bank's efforts on the downswings were as effeciently carried out as they might have been. The bank has always had a tendency to support a market to a point and suddenly withdraw support. Instead of having supported the thing on a gradual basis on the way down they have simply withdrawn support, and you get excess drops in government securities because of that particular action.

COMMISSIONER GIBSON: Now you are talking about the efficacy or the efficiency of their operations.

MR. MILNER: Yes.

COMMISSIONER GIBSON: I was trying to get you

more on whether they should intervene or not and under what circumstances? Let us assume the operations are efficient.

COMMISSIONER BROWN: There is one question while we are on this: First of all, we will go back a little on this question of bills preferably policy. It was explained because there were only 14 members of the I.D.A. in this market that as an association they could not express a view, but for the record, could we have some expression as to the degree of unanimity among the 14 members of the money market?

MR. MILNER: Yes. On the 14 money market dealers I would think we would be unanimously in favour of the operation.

COMMISSIONER BROWN: I just wanted to get that on the record because it was not clear.

MR. MILNER: We have here today about 6 of the money market dealers.

MR. HARRIS: I think in reading the Bank of Canada's brief there are statements one cannot disagree with where they say:

> "In carrying out open market operations to provide or withdraw cash reserves the Bank of Canada usually, though not always, chooses to deal in relatively short-term securities in order to minimize the direct impact of its transactions on the market."

I think we all agree with this in theory, but, as Mr. Hunter has said, the theory does not quite follow because we don't know quite what is

happening, and if we always knew there were offerings for monetary policy in the short end I think it would be better. I think it reads very well, but in practice it does not quite follow. Again they say:

> "... and letting the responses of banks and others to this change work themselves out in the markets ..."

It sounds quite good, but at times there are little mechanical things which upset it: Markets are not the same for one dealer as another.

COMMISSIONER BROWN: These are the techniques; we will get into that later. I wanted to get the principle.

MR. MILNER: You asked the question, and I would say that the money market dealers would recommend Section C.28.

COMMISSIONER BROWN: The next question is that if the Bank of Canada is operating on the short end of the market for the purpose of monetary policy this is obviously going to have a reflection on the long end: How fast do you think this effect should go?

MR. WADDS: Sometimes it does not seem to affect the rest of the market too much. We have seen many occasions in recent years where traditional yield curves have completely vanished. We have had reverse curves.

COMMISSIONER BROWN: Why has this occurred?

MR. WADDS: That is a good question. I would like somebody else to answer that.

MR. BEATTY: This seems to occur when the

yield on long-term government bonds becomes so attractive to a wide range of investors that they become eager to take advantage of it.

COMMISSIONER GIBSON: They then do not respond much to change in the short end?

MR. BEATTY: That is right.

MR. MILNER: Not too much. In recent years, even for the last two years -- let us not bother about the last two weeks; I am thinking about a normal market: You could have a rise or fall in the short-term market of five basis points without having any effect on the long-term market. That would be correct, Mr. Hunter?

MR. HUNTER: Yes.

COMMISSIONER BROWN: Your suggestion is that if it is going through to the long end of the market the Bank of Canada should smooth it out so it does not affect the long-term so quickly?

MR. HUNTER: We may be forgetting one instrument that has not been used for a long time: The bank rate, itself. It is going to have an influence if the monetary authorities felt the thing was getting out of hand, and a bank rate adjustment might temper the psychology of the buyers.

COMMISSIONER BROWN: I agree with that, but what we are trying to deal with at the moment is the question of the bills preferably. What I am trying to get at is an expression of opinion as to what you expect the Bank of Canada to do or not to do in the long end of the market if the monetary policy is going

to become effective through operating in the short end.

MR. ELY: I think the Bank of Canada has to operate in the long-term market from time to time in a smoothing operation so that there is some continuity following through from what they are doing in the short market.

COMMISSIONER BROWN: What I want is the expression of opinion as to how they should operate in this smoothing operation. Say, through their operations in the short market the short-term goes up?

MR. ELY: To carry out monetary policy?

COMMISSIONER BROWN: Yes.

MR. ELY: Yes.

COMMISSIONER BROWN: Is it your conception that they should only gradually increase the rates or operate so that the rates in the long end change only gradually?

MR. ELY: I think that is right.

COMMISSIONER BROWN: In other words, this gives fast movers the opportunity to move before other people?

MR. MILNER: But a smoothing out operation.

MR. ELY: I hadn't thought of it in that light. What I was thinking about was, if the Bank of Canada are carrying out on behalf of the government a monetary policy and operating in the short end of the market -- say, on bills only -- then, there should be some relation between that end of the market and the long end of it, and they should endeavour to do the smoothing operation in the end not so certain fast operators can buy or sell them at levels that may not exist some time later,

but so there is a minimum fluctuation in the top security in the country and confidence is retained in the reasonable changes that take place rather than violent changes.

COMMISSIONER BROWN: This all comes into the question of the speed with which people get the message that there are going to be higher interest rates, and if everybody gets the message that the interest rate is going to change at 5 cents throughout, and therefore the long bonds are going to come down half a point -- I am just asking whether you think this half a point should come down in eighths or by half a point.

MR. ELY: It is a difficult question to answer, but the smoother the operation the less disturbance to the vast number of people who own the bonds always -- who are pure investors.

COMMISSIONER BROWN: If it is going to come down half a point, anyway, this means that some people are going to get down just one-eighth, and the faster this market operates ---

MR. ELY: The faster the change takes place the less opportunity ...

COMMISSIONER BROWN: ... for competent operators in the market to get out before ---

MR. ELY: Yes, I see that. I was taking another view, because certainly some of the confidence that has been shaken, some of the investor confidence that has been shaken has been shaken because of the wide fluctuation in the top security of the country, and one would hope that fluctuation could be mitigated by

a smoothing operation, whether it is one-eighth, three-eighths or a quarter, is the view I was taking. It is a question of smoothing.

COMMISSIONER GIBSON: You are really suggesting that the central bank should have a view about yield curves at any given time. What I would like to ask you, is the same kind of yield curve always appropriate?

MR. ELY: No.

COMMISSIONER GIBSON: Are there times when short yields should be relatively high and long yields relatively low, and so on? If this is the case, what does the central bank do?

MR. ELY: I think the central bank should always have a view of what kind of a yield curve is appropriate to carry out monetary policy, and there would be times when yields on shorts should be greater than those on longs and vice versa.

COMMISSIONER GIBSON: But you are going a long way from the idea of bills preferably.

MR. ELY: I didn't say I was married to the fact they can only be on bills preferably.

COMMISSIONER MACKINTOSH: You didn't say you were divorced.

MR. ELY: There are times when these things cannot be too rigid. The Bank of Canada say the need to co-ordinate central bank operations with government debt management operations is another reason why the Bank of Canada feels it should not rigidly restrict its dealings only in the short-term securities. I think that right: It should not be rigid; there must be some

leeway.

COMMISSIONER GIBSON: You think most of the time it should not be in the long-term market at all?

MR. ELY: I think it should always have a watching brief on the long-term market, but perhaps one could say they should not be in it to the extent they are from time to time.

COMMISSIONER MacKEEN: It has been suggested that the Bank of Canada should intervene in the long market to relieve a disorderly condition. I think it would be helpful to us if you gave us your ideas at what stage an orderly market became a disorderly market?

MR. MILNER: Mr. MacKeen, that is quite a question. A disorderly market, if you take my first saying where it is either up or down, the central bank by operating in the long-term market during that period when it either became a rising or falling market, just using a hypothetical theory -- say, they had $10 million worth of bonds they were prepared to play with. Over the course of a year or so they would buy and sell this $10 million worth of bonds possibly 25 times. Each time they were doing it would merely be to stop the market going up by half of one per cent or half a point in 15 minutes or going down a point in 15 minutes. They would simply use that fund as a levelling influence to stop these very wide swings either way, but they would not eventually accumulate a higher or lower inventory.

COMMISSIONER MacKEEN: Would you say it would become a disorderly market when on the down side you could not get a bid at a reasonable price?

COMMISSIONER BROWN: What is a reasonable price?

COMMISSIONER MacKEEN: Something within the range of what the market had been.

MR. MILNER: Well, government markets should not vary by one per cent overnight in yield -- or, one per cent in price. That is a very wide swing, in our opinion -- to have a market change by one point in one day. There are times, such as we have gone through recently, when that might have been impossible, but under the normal spread in a normal market of government bonds, I think I am right in saying if you had a half a point spread at the maximum would be the normal spread that should exist.

COMMISSIONER MacKEEN: And still be in the orderly market.

MR. MILNER: Yes.

COMMISSIONER MacKEEN: Marketing range?

MR. MILNER: Yes.

COMMISSIONER BROWN: If the street anticipated this was going further, how much would they have to absorb in any one day? This is part of the problem, isn't it?

MR. ELY: A disorderly market -- usually when we talk about disorderly markets we talk about markets that are going down. The reason I bring up this point is that disorder is caused by forced selling, and a disorderly market is caused when dealers, who are merchants just the same as a department store, have inventory on their shelves for their customers who because of the precipitous drop in the market are forced

maybe by the bank from whom they are borrowing the money to finance that inventory. to sell.

COMMISSIONER LEMAN: You don't use Government of Canada shorts as loss leaders?

MR. ELY: Another case of a disorderly market would be when the brakes on the chartered banks are put on too hard so they are literally forced to sell securities to keep their reserves at a proper level -- maybe forced too quickly and in too great volume, far greater volume than the market will take, so you get disorder. Disorder is when owners of securities are forced to sell.

COMMISSIONER GIBSON: Is disorder just the suddenness of the change or the degree of the change, because I would suggest to you at times if the central bank's desire was to really tighten the rein and affect bank lending policies as well as investment policies that quite a significant change in interest rates may be required?

And therefore you might be able to avoid a substantial change; in other words, are you just objecting to the suddenness of it or the amount?

MR. ELY: I am objecting really to the suddenness of it and the degree. Better foresight might mitigate the suddennes and the degree.

COMMISSIONER BROWN: We have heard in all our hearings expressed many times the desire for clearer signals of what the central bank is trying to accomplish.

MR. ELY: Yes.

COMMISSIONER BROWN: And it seems to me that the clearer the signal -- at least I will reverse that, I would like to get your reaction to the suggestion that the clearer the signal the more violent the reaction.

MR. ELY: I think that is quite right.

MR. SHAW: The sharper and more painful the signal the more clear it becomes.

COMMISSIONER BROWN: You are putting the egg before the chicken. If everybody gets a clear signal that we are in for tighter money ---

MR. ELY: Then the sharpness is going to be multiplied.

COMMISSIONER BROWN: Then you are almost in favour of not such a clear signal?

MR. ELY: I think that with better planning the condition could be brought about over perhaps a longer period.

COMMISSIONER GIBSON: In a gradual way through the market?

MR. ELY: In a gradual way through the market than giving a signal which might cause speculation in securities which are not deemed by the investor to be speculative.

MR. MILNER: In other words, Mr. Gibson, what Mr. Ely, I think, is saying is that if the bank for proper reasons wanted to tighten the monetary supply, the flow of funds, that by the time they had tightened them sufficiently the market would have moved prior to that point; in other words, they would have gradually altered the interest rate so that there was not a sudden violent change in one day's time.

COMMISSIONER GIBSON: What you are saying is where you have enough foresight to avoid crises?

MR. MILNER: No, crises are a different thing altogether. That is a thing that is almost impossible to cope with but on normal business conditions.

COMMISSIONER GIBSON: To avoid disorderly conditions on the market.

MR. MILNER: To avoid disorderly conditions. Forgetting about this last month, in the last two or three years there have been very marked changes in interest rates, very wide swings in interest rates that I would think could have been evened out to a much greater degree than we have witnessed.

COMMISSIONER BROWN: How would this be accomplished because there was no clear signal in that period? They were all gradual and they became clear as people knew what was happening.

MR. MILNER: I think that the central bank,

for instance, after they changed governors a year or so ago, there was a pretty clear signal given that the monetary policy was being altered and money would become easier. This would take a certain amount of time for that to get into the stream and it was then tightened up at odd times here and there because they had got too much money in it and I think in the last year or year and a half that we have witnessed bank signals and I think if you go to England, for instance, or the American market usually what happens there is that the bank rate is altered after the event is over. The market activities would, owing to the fact that money is becoming easier, there will be a drop in the bank rate and should the drop occur it does not affect their long-term or short-term market to any appreciable extent.

COMMISSIONER LEMAN: I would like to get something a little more clear in my mind as to what is the balance of your opinion on this matter. You said that if the Bank of Canada as a matter of course stayed out of the long-term market the market itself would be broader and I presume you meant by that that it would tend to be more orderly, does that follow?

MR. MILNER: Yes.

COMMISSIONER LEMAN: Are you in fact saying the bank should adopt this policy and when the investment dealers, those who are in the primary market for securities, are unable to keep it orderly then the bank should step in? Is it not reasonable to assume that for someone to accept this sort of last resort job

to back up a market that has become disorderly, it is much easier to do this if the primary agents figure in their own minds how they will operate from time to time to prevent disorderliness.? It is hard to accept this sort of last ditch job. You cannot guarantee to the Bank of Canada that you can keep the market orderly, can you?

MR. COX: No, we cannot control our customers.

COMMISSIONER LEMAN: I think a fellow, any institution or agent is entitled to have the whole job to do or nothing at all.

MR. WADDS: There is a pretty wide range of opinion as to how much the Bank of Canada should be in this long-term market. I do not think it should be in it at all under any circumstances and then we would have a market that would be at least realistic. This is a personal opinion but I would far rather take my chances with free market forces than dwell in the field of uncertainty that we are in at the moment and I think it is fairly general here, as shown by dealer inventories, that there is a reluctance on the part of most dealers to take long Canada bonds. At the same time I think many of the dealers have taken very substantial positions in long-term provincial bonds which is a pretty free market. You can see this fact by long Canadas to a certain extent but nevertheless there has been more incentive to take positions in long-term provincials than Canadas for some time.

MR. COX: You know central bank cannot use provincial bonds to implement its monetary policy.

COMMISSIONER GIBSON: So you have a pretty wide range of opinion on this, really.

COMMISSIONER BROWN: If the Bank of Canada were out of the long-term bonds and there was this change in the short-term Canadas would you change your long-term markets?

MR. WADDS: Well, a free market is supply and demand. I do not think we would significantly change our long-term market. You take these long bonds on the premise that you can sell them; it is not a speculation.

COMMISSIONER GIBSON: You have to assess the market and make up your mind?

MR. WADDS: Yes.

COMMISSIONER GIBSON: One other thing about this business about the long operations by the Bank of Canada that I would like your opinion on: Suppose the country has an investment pool and there is more capital investment going on than you have got resources to handle, in other words, the situation brought about by a big capital investment boom -- and we have had this situation in Canada. Some people believe in those circumstances that the central bank should deliberately try to place the rate of interest, If so, if you tell us you are not working the long-term market, that may not work as well. Any thoughts on that?

MR. COX: They have got a whole set of tools available to them and open operations is only one. Could they not influence the trend of interest rates by using some of their other tools?

COMMISSIONER GIBSON: I do not say this is likely to happen often but it has happened when you are in a position where you have a capital investment boom which is excessive on its demands on the economy.

MR.COX: Like we had in 1955 and 1956?

COMMISSIONER GIBSON: Yes. What do you do? Do you just work in short things then?

MR. COX: Won't the demand for capital change interest rates by itself if the demand is greater than the supply?

COMMISSIONER GIBSON: That is what I am asking you.

MR. COX: Won't interest rates go higher without central bank action?

COMMISSIONER GIBSON: It should but maybe the central bank wants to give it a push.

MR. COX: I would think it would be appropriate to think about using some of the other tools they have at their disposal.

COMMISSIONER MACKINTOSH: I think the difference between you and Mr. Ely is that he would nudge that yield curve along.

MR. ELY: I think there is an essential difference in our opinions here. I find it difficult to think that they should not exert some influence in the long-term market.

MR. SHAW: Perhaps I had better stand up and be counted here. I would like to go back to the wording in the brief and, speaking in a personal point of view because even within one organization you will get

different points of view -- I think personally that the Bank of Canada should operate strictly within the bills preferably area, the exception being during periods of crises rather than disorderly markets. We have been trying to define disorderly markets and I think Mr. MacKeen came as close to it as I might have done that when you get no bid within a reasonable length of when the last previous trades have taken place or no offerings within the same limit you are in some sort of a disorderly market. The dealers should have the opportunity of contending with that in their own way to the point where, if it gets completely out of control then I think you get into a period of crisis and at that stage the central bank, in my view, should depart from the bills preferably concept. I think the wording here would clear my position.

COMMISSIONER MacKEEN: Mr. Shaw you think if the Bank of Canada had no long-term bonds they could not do anything very much to halt a disorderly upswing, could they?

MR. SHAW: They might like to do as we have to do; they might have to borrow some from the dealers who were short. If we found ourselves in that very desirable position I would think the chances of a crisis developing would be considerably less.

COMMISSIONER GIBSON: I think we have discussed this question at a fair length. Could we go on to the question of the term of the national debt. In Section B, paragraph 35 you suggest that the term of the national debt should be a bit longer in Canada than the

States because of the more open type of economy and less developed markets. What do you think the average term of the debt should be in Canada as a general proposition?

MR. ELY: I have said, Mr. Gibson, that I think it should be longer than in the States, the reason being that in the States semi-government bodies finance themselves in the long-term market whereas in Canada government bodies are financed by the government. Those same bodies that would be long-term borrowers are financed directly by the government. I do not know how you put your finger on exactly what average term our debt should have but let me put it this way, that the problems that have been created in the American market by having the very short debt are not insurmountable but they are close to it and they have the problem of raising money coming at them every few months and if that circle continues where do they end?

Now, therefore, one assumes that the longer your debt the easier the debt management becomes and certainly for borrowing on the part of the government in many cases money they borrow is for long-term purposes. On balance I would say that the longer we can keep the average term on our debt in this country the better conditioned by the fact that they must have at all times enough debt in the short-term sector to control monetary policy.

COMMISSIONER GIBSON: Then, how do you go about carrying out this objective of keeping the period

of debt as long as you can? You are suggesting that when conditions are depressed there should be a good deal of refunds and conversion of long returns?

MR. ELY: How do you go about it?

COMMISSIONER GIBSON: Yes, because when conditions are depressed you want to get the stimulus from monetary policy in terms of somewhat lower interest rates and if you take advantage of that to refund a good deal of debt to longer terms you may not pass this benefit along to the private economy to the same degree. In other words, there is something of a conflict here between desire to convert the long-term and the desire to stimulate the economy by lowering the interest rates. What are your views on that?

MR. ELY: I see what you mean and I appreciate it. The reason we have not been able to extend the average term of our debt is a certain lack of confidence in the securities involved. If that confidence returned by proper management of our over-all policies there would be a greater tendency on the part of Canadians to buy the long-term debt and in that area it may be reasonable to expect that there would be more stability in the long-term market which is what the long-term investor is looking for.

COMMISSIONER GIBSON: And the idea of stability in the long-term market is the real motivation, in your thought, that we do things in long terms in periods when business is depressed and when there is an upturn in business you would accentuate the rise in long-term interest rates?

MR. ELY: That is right.

COMMISSIONER GIBSON: And this is really a very interesting dilemma -- and it really is a dilemma -- between debt management and monetary reform?

MR. ELY: Yes.

COMMISSIONER GIBSON: Anyone else have any views?

MR. MILNER: That is one of the things that is right throughout our thinking, that that would be one of the methods of stopping the greater fluctuation in interest rates.

COMMISSIONER GIBSON: Don't you see lower interest rates sometimes and higher interest rates at other times as useful tools of national economic policy?

MR. MILNER: Yes, but I do not think the very wide spreads are as effective as more gradual changes in interest policy. Following your line of thinking we would never have as high a long-term market if at times when we wanted to make money easier instead of having our interest rates go to, say, 3 per cent they would only go to, say, 4 per cent because there would be a greater pressure on the longer term market. We would not have nearly as wide swings as we have had.

COMMISSIONER GIBSON: But the question I am really trying to get to is do you think the combination monetary and fiscal policy could be effective if there were not quite wide swings?

MR. MILNER: Those swings could be more accentuated in the short-term and less in the long-term.

COMMISSIONER GIBSON: Really you are saying

you would like really more stability in this picture than we have experienced in recent years. That is a fair statement, is it?

MR. MILNER: Yes, that is a fair statement.

MR. ELY: We are really portraying the views of the investor along that line.

MR. BEATTY: It has been used to a great extent to combat business cycles.

COMMISSIONER LEMAN: But going back to the matter of signalling, don't you think with this process you might take as a signal the decision by the federal government to lengthen the term of its debt at any moment as an indication that in their view they have about come to the peak of the market? Would it not be interpreted as such?

COMMISSIONER BROWN: What would be the effect on the market?

MR. BEATTY: It would tend to reduce the extent of the swings.

MR. SHAW: Should not the federal government be expected to take a somewhat different view there than other credit such as provinces and municipalities or corporations who understandably seek to float their issues at the most favourable level of the market to them whereas when dealing in the federal field and you have many objectives, that the federal government should not be so concerned with reaching the top of the market for their financing? If they are right in that objective or successful in that objective then they sell their issues at the time and in the meantime the public who own them are a discontented lot.

Their objectives are manifest although I do not think the federal government should be quite prepared to accept the difficulties involved in operating long term issues perhaps at the higher level of the market. This would satisfy that and would achieve that objective of lengthening out the debt, making your other tools in the monetary policy field much more effective.

COMMISSIONER GIBSON: With the benefit of hindsight on this whole question of term, would you care to express an opinion about the effectiveness of the conversion operation of 1958?

MR. SHAW: The effectiveness or the effect?

COMMISSIONER GIBSON: The effectiveness.

MR. SHAW: It is quite effective, I think, in obtaining the objectives they set out to obtain. It is a successful operation from the point of view of the government to extend the term.

COMMISSIONER GIBSON: Yes, but looking back on it?

MR. SHAW: Looking back on it now, the cost may have outweighed the advantages to some extent. I do not adhere to the view that it was an entirely bad thing, but it did bring in some very unfortunate developments.

MR. ELY: I think it is quite fair to say here that at the stage when they were initially under-way on the conversion loan there was very marked deterioration in the American bond market to which our market bears a relation, so that some of the

criticism, I think, should be mitigated if one looks at what happened in a market right next door to ours which we could not fight.

COMMISSIONER GIBSON: What I am really getting at is, do you envisage that we are going to have to do a job like this every five or six years to get reasonably stable, and if so, what did we learn from the last conversion?

MR. ELY: No, I do not think we have to do a job like this every few years, Mr. Gibson. I think it can be done gradually at the appropriate levels, because with the stability which we ask for and the same increase in confidence in the way the country is being handled, there is a market for long term securities. There is a sufficient market for long term government securities to allow it to issue long term securities.

MR. MILNER: The conversion, Mr. Gibson, was too great for the size of our debt. The conversion was too big. Had that been, whatever percentage you want -- 15 or 25 per cent of what they bid -- there would not have been the repercussions that occur. I am certain of that.

COMMISSIONER BROWN: You mean, in other words, if they had not been so successful in their operation it might have been better?

MR. MILNER: Yes, at the beginning it was too big. We tried to do too much in one operation. Of course, the handling of the after market in our opinion was a tragedy.

COMMISSIONER GIBSON: Of course, there was no escaping the fact that interest rates were going to go up. They went up abroad.

MR. MILNER: Yes, they went up everywhere.

COMMISSIONER GIBSON: They went up here. In your opinion did it accentuate the rise, or was it about the same?

MR. MILNER: The chartered banks knew very well what would happen. When the chartered banks foresaw the change of interest rates the government maintained its purchase funds at par until they bought back a huge amount of bonds. That effect would not have occurred had the government had an orderly market, alternating their price until the selling dried up. I do not know what the price would have been, but it would not have gone from par at the opening to around 96 or 97 in about one minute.

COMMISSIONER BROWN: They should have gone down gradually?

MR. MILNER: They should have kept dropping off until the selling dropped off, but by arbitrarily setting a standard price with a sum of money involved and just running out of the money and that was the end, that was a bad thing.

MR. WADDS: This also occurred on the longer end with the insurance companies; particularly in relation to the long conversion bonds. They immediately saw the changing interest rate and they unloaded them as quickly as they could, so there was quite a lot of pressure on the Bank of Canada.

COMMISSIONER BROWN: This was the point that we were discussing earlier. The more people that become sophisticated, the faster that happens in any event.

MR. WADDS: That was my original argument, Mr. Brown. If bonds start to disappear the sellers stop selling. This is the practical effect. They cannot sell and they will not sell them scaled down.

COMMISSIONER GIBSON: Would you like to talk about bank rates? In your recommendation 23 you suggest that the bank rate should be re-established, but in recommendation 24 you also say that the present system of a floating rate should continue to apply in money market jobbers.

At the present time we have just about this, of course; we have got a special announced bank rate and a bank rate which is a quarter over the treasury bill rate for money market jobbers.

In Section C, paragraph 43, it states that the dual rate does not seem to make too much sense if people do not borrow money at both rates. Supposing you suggested that the chartered banks borrow at 6 per cent and the money market dealers at the other rate; what about this? Do you like this change in securities from the point of view you had in mind?

MR. MILNER: Here again we had differences in our own viewpoints of the dual rate, but if I may

speak for a moment about the fixed bank rate I shall do so.

I know that there is great difficulty in a country such as Canada being so close in the North American continent to the United States that a fixed bank rate here is much more difficult for us than for most normal countries. On the other hand, it is overweighed, in my opinion, by the fact that I think all over the world we have in all the so-called free world where there are central banks, what is known as the bank rate, the bank rate gives an indication to outside people of the general monetary conditions which necessitate the bank rate being at whatever it happens to be at -- 3, 4 or 5 per cent.

We were practically unanimous in our viewpoint that Canada over a long period of time would be far better off with that fixed bank rate as an indicated rate even though it is not used to the same extent here as it is used in other countries with the central banks.

When it came to the money market dealers, this was in a rather difficult category. As you well know, in the American market they have no such thing as a double rate, but they have another method of accomplishing the same thing. This is done by the federal reserve being willing to purchase securities from money market dealers with no obligation to purchase. It is clearly a different type of purchase and resale. We have a line of credit. The money market dealers

have obtained that line of credit, and we think that the quarter penalty rate is a perfectly rational situation compared to a similar situation in the United States. We also came to disagreement among ourselves as to whether two rates might defeat the purpose of only having one rate. I think Mr. Harris should start in this regard because he was one of those very interested in this bank rate.

MR. HARRIS: I was looking at this situation from the money market point of view. First of all, speaking from a very selfish money point of view, the variable rate fills a useful function inasmuch as it irons out changes in availability of day loans. We have to bank our inventory in that day loan market. There have been operations of the central bank contrary to chartered banks, which has kept the cash requirements pretty strict over the period of recent years. There were times when money was not available so dealers had to go to the Bank of Canada quite often, although the Wednesday evening figures only show this as eleven weeks in 1961 for the total year. However, I think that on many more occasions it happened other than on Wednesday nights. The dealers, if they carry an inventory, take a responsible role in making any difference in the money market. Money market dealers feel there is some accommodation available to them. From a very selfish money market point of view we feel we could be satisfied with this rate, and it is recommended in the money section.

When you actually come to the two rate system setup, the immediate problem is, would anybody borrow at the 6 per cent rate; would the money market dealers help the chartered banks out so that nobody would be using the 6 per cent? If the Bank of Canada took these steps and the dealers would not undertake to help the chartered banks out during periods when things were tight, this is a problem. I think this is a necessary move to make this thing work. I am sure that they would abide by that policy. If we have to try to continue to keep that amount of money market securities which are necessary in the development of the money market, one needs to know where the source of borrowing is.

At times in the past certainly when we had a fixed bank rate there was a wide spread between the bank rate -- in 1955 and early 1956 -- and the money market rates. Since then I think the money market has grown because the dealers have felt a little more secure in holding money market securities.

From the money market point of view there is an advantage in a flexible rate. There are certain differences in this point of view.

MR. MILNER: Mr. Cox, would you like to comment in this regard?

MR. COX: The point of view that I took was that any hint or indication that there was a dual rate took away from the effectiveness of the fixed administered rate. I think that we all agreed that we wanted this

returned to a fixed rate because this is a signal that indicates that a change in economic conditions are in the offing or perhaps have already commenced to show up.

The point of view I took in respect to the special lower rate to the money market dealers was that if the bill rate dropped considerably lower than the bank rate -- say that the bank rate was 6 per cent now and the bill rate got under 5 -- somebody is wrong. If the dealers are able to move their bills at something under 5 per cent the Bank of Canada monetary policy is not in keeping with its administered rate level. On the other hand, if the dealers are wrong in bidding bills up to something under 5 per cent, I do not quite see why they should get a special cushion for them. In the normal course of events in our business if your judgment is wrong you pay the penalty, and if your judgment is right you profit from it.

I should like to say in passing also that subject to the change in the bill level today the dealers are now able to borrow at 5.68. You technically borrow at 6 per cent but because you borrow at 7 and only get credit for 5, when you are establishing your cash ratio, I do not think it is unfair to say you pay 6 plus 40 per cent which is 8.40.

I think that perhaps Mr. Rasminsky has recognized the same difficulty in the weakness of his position of having the dual rate by getting in touch with the banks and dealers. I would not like to think that we are going to leave this dual operation in force

too long, because this would enable the bank, if it saw fit again, to get away from the fixed rate. They hint in their submission to you that there are pros and cons both in respect to a floating rate and a fixed rate. I would think I would not like to see them get away from the fixed rate.

COMMISSIONER GIBSON: In other words you would like to see them, if it were possible, return to one fixed rate?

MR. COX: Yes.

COMMISSIONER GIBSON: What would you think about a compromise idea; instead of having one-quarter of one per cent of the treasury bill rate for the floating rate to have a variable percentage above the treasury bill rate depending on what the Bank of Canada thought? If it thought money was getting tighter it might make it one-half, or if it was getting loose or easier, it might make it one-eighth.

MR. COX: That would still defeat the effectiveness of the administered rate, in my idea.

COMMISSIONER GIBSON: I suggested that instead of the other, Mr. Cox.

MR. COX: I would not like to see us get away from the administered rate.

COMMISSIONER GIBSON: If you varied the rate it would be a signal. It would be a conscious act there for people to see.

MR. COX: Would it be as well understood?

COMMISSIONER GIBSON: I do not know.

MR. COX: Would it be as well understood

internationally as domestically?

COMMISSIONER GIBSON: It would be more technical, that is clear. Would you say it would be desirable in your opinion?

MR. COX: I think it would have some effect, but I do not know that it would be quite as effective.

MR. WADDS: I do not think it would be as effective as the floating rate which we have had, which was virtually nil outside the country as well as inside. This was the one thing we could look to to give us some guidance.

COMMISSIONER GIBSON: But if the Bank of Canada instead of saying that the bank rate is one-quarter over the treasury bill rate, it said it is one-half over the treasury bill rate, this is an expression of opinion and not an automatic thing.

MR. WADDS: It is still affected by the public tender, is it not?

COMMISSIONER BROWN: What do you think the effect on public tender would be?

MR. WADDS: The only reason I say that, Mr. Brown, is that it has happened over the years and has been occurring on the bill market and it always seemed to me that there was a strange thing when we had a so-called fixed rate that could be affected by the dealer or somebody blowing up the bill rate. This is not a signal to anybody except to those individuals who want to pay a lot of money for bills.

MR. COX: There is one other thing involved here. It is recognized by some that the central bank policy could be more effective if they used more than one tool; if they used the open market policy to change the bank reserve, and they also want to change the interest rate. If they change the discount rate at the same time, probably the open market operation could be less extensive with less risk of creating disruption in the market.

COMMISSIONER GIBSON: Do I detect a difference of opinion between you and Mr. Harris? You would like to go back to the fixed rate and drop the floating rate?

MR. COX: Yes.

COMMISSIONER GIBSON: And Mr. Harris, I think, likes the dual system, is that fair?

MR. HARRIS: From the money market point of view it is better. From the strict point of view of the money market it plays a useful function.

COMMISSIONER GIBSON: This is part of the consideration. Do you think the floating rate is good from the money market point of view?

MR. HARRIS: Again going back to the problem discussed before the recess, it floats back and forth. We do have a problem in moving funds back and forth. This is affected by the situation in the United States. If you are going to have a bank rate that is fixed, I think that it is indicated it has to be fixed for a reasonable length of time and not as a result of

difficulties in the money market caused by changes taking place between the two countries interchanging short funds. Certainly from the money market point of view there are difficulties involved.

As I say, there are other arguments. I do not think the money market dealers disagree with the other arguments at all, but there is this conflict.

COMMISSIONER GIBSON: What do you think about the idea of changing this to a sort of floating rate?

MR. HARRIS: I must say that it is a new idea which I had not thought of before, or even heard mentioned. On the whole I do not know whether it would help. Perhaps it might to a certain degree. I still feel this quarter of a point is a good working figure for the money market. I think we are better off with one or the other, but I do not think that would really solve the problem. It would be another way of avoiding certain responsibilities. I suggest this would create delays in making the change. The Bank of Canada again seems to feel here that the fixed bank rate might be changed, but that the bank rate would be delayed until it was more certain that a change was indicated. This again brings up the other problem of when to change it, and when to give the signal.

MR. MILNER: Mr. Ely, do you wish to say something in regard to this subject?

MR. ELY: I was one of those who had views that we should consider a dual rate. The reason for having a different rate for many market dealers than the fixed bank rate in my opinion was that if bills were selling considerably below the administered rate it would considerably inhibit the size of the money market if dealers had to go into it at a penalty, and the size and depth of the money market is an important thing in this country. These are my considerations in suggesting that they should hang on to the quarter of one per cent above the average so that there wouldn't be a large penalty at times which would make hills and valleys in the broad concept of the money market.

COMMISSIONER GIBSON: I am just trying it out.

MR. ELY: Your idea that from time to time there might a change in that quarter of one per cent, according to which way the income was going, I think has a lot of merit; It is worth thinking about and studying because it could act in a smoothing way with regard to the money market.

MR. SHAW: Is it the case, Mr. Chairman, that the spread between the money rate and the bank rate of as much as one per cent necessarily means that somebody is wrong? Is it not true that in England -- I have a chart in front of me here from the period 1952 to 1954 -- well into 1954 -- and the spread between the treasury bill and the bank rate was 2 per cent in favour -- the bank rate was at the higher level, the bank rate was staying at 4 per cent, I think, and

the treasury rate was reaching between 2 and 1-3/4, and isn't that sort of thing likely possible to happen without necessarily one or the other being wrong? We don't want to change too frequently; we have seen occasions in the States where the bank rate has been below the bill rate for some little time and the dealers have been able to take some benefit from carrying this on inventory for their own account.

COMMISSIONER BROWN: I wonder if the example you quoted in the U.K. treasury treasury bill rate is entirely pertinent, because over there so many other things are tied to the bank rate.

MR. SHAW: To that I agree.

COMMISSIONER BROWN: And that doesn't apply here?

MR. SHAW: No.

COMMISSIONER BROWN: The other question I would like to ask is if the bill rate is considerably below the administered rate or the fixed bank rate, how effective is this fixed bank rate?

MR. ELY: It becomes less effective if that takes place and rather indicates that the fixed bank rate should be reduced. The interest rates are tending towards what the market-place thinks -- the way the market place thinks the economy is going.

COMMISSIONER MACKINTOSH: Can I ask a question; by a fair bid or by this open market operation, or both, can the Bank of Canada fairly well control the bill rate?

MR. ELY: As you probably are aware, Dr. Mackintosh, the Bank of Canada always -- there is always

a bid made by the Bank of Canada at each auction for the entire issue in case there are not enough bids from other money market concerns to take up the option, so therefore they can have a very marked effect.

COMMISSIONER MACKINTOSH: What I am getting at is if the bank rate is fixed and your bill rate is 5-1/8, or whatever it is, has the Bank of Canada the tools to move the bill rate into what it thinks is the proper relation?

MR. ELY: Yes, issue more bills.

COMMISSIONER MACKINTOSH: And maybe that is the system?

MR. ELY: It is part of the system.

COMMISSIONER MACKINTOSH: And this problem of the two being in conflict if the Bank of Canada acts in this way ---

MR. ELY: If they take the proper action it disappears.

COMMISSIONER MACKINTOSH: I don't think we can devise any system that will work if the Bank of Canada acts in a different capacity.

MR. ELY: Quite correct.

COMMISSIONER GIBSON: On the question of the two kinds of rates; floating rates and tax rates, is there much difference in the response in investment dealers in their attitude and the advice that they give their clients to the signals that are received to the two types of rate. How do you respond to the floating rate?

MR. COX: I don't think the floating gives

you much of a signal in the fact it moves a few points from week to week. I don't think this is a basis for advising your clients one way or another.

COMMISSIONER GIBSON: You don't regard it as a signal generally?

MR. COX: No.

COMMISSIONER GIBSON: Even though the Bank of Canada is a major factor in the market?

MR. COX: This is something you may or may not know and they refrain from saying, or they may be buying bills or selling bills for one of the government accounts.

COMMISSIONER GIBSON: This is your basic objection to the floating rate, that it is not enough of a signal?

MR. COX: That is my objection, yes. I don't know that I should speak for the association there.

MR. MILNER: In the past few years the floating rate that we have was influenced by causes that had nothing to do with the monetary supply outside of the fact that if you had a very large delivery of , say, Quebec Hydro and Ontario Hydro at the same time it would affect the chartered banks in their loaning position and you have a fluctuation of the bill rate that wasn't caused by anything monetary, it was caused by a delivery problem and the publicity in the paper saying,"The bank rate goes up 11 points during the week" and it didn't go up at all and there was no change in the monetary policy.

COMMISSIONER GIBSON: This happens frequently.

MR. MILNER: Oh, it happens frequently.

MR. HUNTER: The bank rate is the only

indication other than the annual report which the Governor publishes as to what his thinking is during the year, and I think we all feel we would like to know when he has changed his opinion about things because the bank rate is virtually the only way we know whether there is a strong market or not.

COMMISSIONER GIBSON: And this is something which would happen only rarely?

MR. HUNTER: I shouldn't think it would happen often.

COMMISSIONER GIBSON: How are you going to run your money market if you just have a bank rate that changes once in a long time?

MR. HUNTER: Well, I have been with a firm and in the money market business and I don't like the idea of the floating rate from this point of view, but if were to run the risk of losing the fixed bank rate I think we would invariably be prepared to work on the bank rate rather than the bill rate.

THE CHAIRMAN: We shall adjourn now until 2.00 o'clock. We will not be through by 4.00 o'clock this afternoon and I am saying this for the benefit of those who have in mind leaving on the 4.00 o'clock plane because I think it is pretty definite we will be longer than that.

--- Luncheon Adjournment.

--- On resuming at 2.00 P.M.

THE CHAIRMAN: We will now resume.

COMMISSIONER BROWN: I wonder if I may ask a question in connection with secondary reserve requirements of the chartered banks. You recommend that the chartered banks be released from the requirements on secondary reserves. My understanding is that when this was instituted one of the thoughts behind it was that by forcing the banks if they wished to expand contra monetary policy to sell short-term Canadas which would involve a greater loss that this would dissuade the banks from taking this action, and we rather gather from C.40 that you don't think this is quite operative.

MR.COX: I think the major objection I had was this falls under the heading of moral suasion because there is no legislation. The Bank of Canada persuaded all the banks to agree to endeavour to maintain -- I think that was the wording. This thing has been in existence now for six years, and it is usurping the power of government to legislate.

COMMISSIONER BROWN: Let me reword my question. Do I gather from your remarks now that if this were made part of the Bank Act that you would not have the same objection?

MR. COX: I think this is something that probably should be examined in greater detail, and that a fairly good case can be made suggesting they are not particularly effective if we are free to presume -- and I think we should presume -- that the banks are going to follow a normal, prudent policy of extending credit. Most of

the time since they have been in force the banks have had essentially more than 15 per cent in cash and secondaries. Therefore, it performs no useful function other than perhaps getting some cheap money for the government through treasury bill options by creating a captive market.

On the other hand, when the banks find that the loan demand is high, and these are good and proper loans that they are making, they have to sell securities. They won't sell bills; they will sell bonds. Presumably this is a time when the Bank of Canada is trying to tighten, and you may run the risk of a disorderly market, if I may get back to that again, by the bank having to reverse its monetary policy and acquire some securities to prevent the market from dropping too fast.

COMMISSIONER BROWN: I would like to have your reaction to the suggestion that if the Bank of Canada is trying to tighten things up, and if the chartered banks have treasury bills which they can sell without really costing them much, is this making it more difficult for the Bank of Canada?

MR. COX: Do they not have to keep the treasury bills to fulfill their secondary reserve requirements?

COMMISSIONER BROWN: If your suggestion were followed out and they didn't have to keep the secondary reserve ratio ...?

MR. COX: I see what you mean.

COMMISSIONER BROWN: I am asking for your impression as to whether this would or would not make

it more difficult for the Bank of Canada to tighten things up?

MR. COX: This would only be true to the extent the chartered banks have excessive reserves -- they have more bills than they require or more day loans than they require under the 7 per cent requirement.

COMMISSIONER BROWN: I think you misunderstand: If they didn't have the 7 per cent requirement.

MR. COX: I see.

COMMISSIONER BROWN: Would that or would it not make it more difficult for the Bank of Canada to implement its monetary policy?

MR. COX: Well, I suppose it would if you presume the banks won't be prudent and that they are prepared to get themselves into an over-extended position where they have no excess liquidity at all. I don't think it would be a fair presumption that our Canadian banks would put themselves in that position.

COMMISSIONER MACKINTOSH: Of course, if you assume that (a) the banks are prudent and (b) prudence requires 7 per cent treasury bills, then it doesn't matter whether you have the regulation or not.

MR. COX: I don't know whether 7 per cent is the right figure, sir.

COMMISSIONER MACKINTOSH: Whether it is desirable or not, the whole practical effect is to force the banks, if they are liquidating securities in the face of Bank of Canada action to liquidate them at some greater loss than if they took them , so to speak, off the bottom of their treasury bill portfolio.

MR. COX: Yes.

COMMISSIONER BROWN: In effect, this makes the central bank policy more quickly operative?

MR. COX: Under certain circumstances it would, yes. I think our objection to the thing lay mainly in the area that if it is deemed that this is a desirable thing, when the time comes to revise the Bank Act in 1964, that this should be taken within the moral suasion area -- the agreement area -- and legislated.

COMMISSIONER BROWN: This puts quite a different aspect on your recommendation.

MR. COX: I think that is what I have said in Section C, Mr. Brown.

COMMISSIONER BROWN: Your recommendation is emphatically that the Commission consider recommending that the agreement between the chartered banks and the Bank of Canada in 1956 establishing secondary reserves be terminated. Do I understand from your reply that you really mean that it be terminated or established by legislation? This is on page 7 of Volume I.

MR. COX: I am looking for the text in Section C.

COMMISSIONER GIBSON: C.40 on page 22. You say that it might lead to a disorderly bond market.

COMMISSIONER BROWN: I think there is no point in pursuing it further because we have got your thoughts on it, and it is not quite exactly what we understood.

MR. COX: I have got something here some place, and I just can't find it.

COMMISSIONER BROWN: We might be able to come

back to it later. Then, in this context there is another thing: If the secondary reserve ratio were removed as a requirement what effect do you think this might have on the availability of day-to-day funds to the money market?

MR. COX: I think it would tend to increase it.

COMMISSIONER BROWN: Would you like to develop that a little bit.

MR. COX: Possibly someone in the money market might be better qualified.

MR. HARRIS: This is a little difficult to come to a decision on right away. I quite honestly, not having thought of it, don't know the answer to it immediately. At times I think it probably would squeeze the money market when there was a pressure for funds for cash position. At other times it might go higher. The secondaries have been running around 19 per cent -- just recently they were well above the the 15 per cent. One might presume the funds under normal conditions would be available to the money market that are now to the day-to-day loans, but I would like to think about that one.

MR. MILNER: Do you want to comment further on that, Mr. Cox?

MR. COX: No, I don't think I have anything else.

MR. MILNER: Mr. Brown, would you want us to give you a better answer on that later?

COMMISSIONER BROWN: I don't think we want to

recall you at all, but perhaps you might submit a paper on it.

MR. MILNER: Would you like to say anything, Mr. Ely?

MR. ELY: Yes, I think my view would be that the 7 per cent moral suasion part of the 15 per cent reserve should be enacted into the Bank Act, and that if it was eliminated it would have a tendency in some cases to have maybe too much money available, and in other cases not enough; and I think it is working. I think we have gone through some pretty troubled times in the last few years and, by and large, I would be of the view that it works. I would not think it should be removed. I would think it should be put into the Bank Act.

COMMISSIONER GIBSON: When you say it works, what do you mean by that?

MR. ELY: If it were not there there might be times when the chartered banks would channel some of that 7 per cent into general loans. There might be quite a few times when that would happen, and then there would be less money available in that area to finance the government's requirements in the bill market.

MR. HUNTER: May it not also have a tendency to persuade the Governor to increase the cash reserve requirements from time to time which would be an expensive thing for the banks?

COMMISSIONER GIBSON: If you remove it?

MR. HUNTER: If you remove it: Not having that additional 7 per cent protection you might then feel

it necessary to increase the cash reserve requirement to 9, 10, 11 or 12 per cent ultimately.

COMMISSIONER LEMAN: Would you go so far as to say there should be a variable reserve -- that the Bank of Canada should be able to vary that 7 per cent secondary?

MR. ELY: It is variable now, and I would think when you inject it into the Bank Act there should be leeway to vary it.

COMMISSIONER LEMAN: It should not be fixed at 7 per cent?

MR. ELY: 7 per cent is a good figure, but under certain conditions perhaps there should be some leeway.

COMMISSIONER LEMAN: What makes 7 per cent good?

MR. ELY: I suppose that 7 per cent figure coupled with the 8 per cent cash figure came out of experience and it has worked. That is what makes it good.

COMMISSIONER BROWN: Would it work in another period?

MR. ELY: Under certain sets of conditions it would work -- under certain sets of conditions it might be raised or lowered.

COMMISSIONER BROWN: Would this be in part related to the availability of treasury bills?

MR. ELY: I don't think it should necessarily be related to that.

COMMISSIONER BROWN: Would you see any danger

that if the government wished to finance more on a treasury bill basis than they do so, and at the same time increase the requirement to 10 per cent ...?

MR. ELY: I would hate to think that would be the case, because that would be the wrong usage of it.

MR. SHAW: Isn't the test that it has worked, or one of the evidences of it, the fact that the banks as a rule are over a period -- and I am speaking strictly from memory -- but isn't it the case that the banks have maintained something more than the 7 per cent rate much more often than they have crowded the 7 per cent rate, and it has been more like 16, 17 or 18, and isn't that the evidence that maybe this is a good level?

COMMISSIONER LEMAN: Don't you think if the 18 was the base they would try to be around 20 most of the time?

MR. SHAW: If they are as conservative as we know our banks to be ---

COMMISSIONER BROWN: To give themselves a cushion?

COMMISSIONER LEMAN: They don't want to be locked in the situation more than anybody else, so if you make it 19, they will hover around 20 or 21.

MR. SHAW: Perhaps my assumption is wrong. It seemed to me, observing over the years, that they seemed to be more often comfortably above than just crowing it within .1 or something.

COMMISSIONER LEMAN: That is the same -- to have a little cushion or a little leeway. What proof is there that 7 per cent is good? Mr. Ely says it

has worked. Perhaps what is meant is that a secondary reserve works. We are talking about 7 per cent. Is there any magic in 7 per cent?

THE CHAIRMAN: I would like to know what you mean by saying it works. What do you mean by that? There is the 7 per cent reserve which has been adhered to: What do you mean by saying it works?

MR. ELY: What I meant by that, Mr. Porter, was that that 7 per cent relates to the amount of money available in the chartered banks for the purchase of treasury bills, and the amount of money that the government wanted to raise in that area -- the banks throughout the 7 per cent reserve seem to have been able to absorb it fairly easily and comfortably. So, it works in the context that the number of bills that are issued at the weekly auction and the 7 per cent seem to go together comfortably.

COMMISSIONER GIBSON: Mr. Milner, you have some disagreement in your association in this matter. Mr. Cox suggests it does not work and it creates a disorderly condition in the market at times; isn't that right?

MR. COX: It might.

MR. MILNER: Well, Mr. Gibson, if you will follow our brief as a whole we have endeavoured not to dictate or to suggest specific things which we believe to be out of our province. For instance, when we come to the matter of what we call the near banks we do not suggest that a regulation covering near banks should be modeled after the reserves of the primary. We don't

know that is the correct basis or not. We merely say we think the government should have some control over the loaning policies of the near banks, but as to what that control is we don't feel ourselves capable of giving a reasonable opinion, and when we come to the subject of the secondary reserves of the chartered banks we merely point -- and I don't think there is quite the disagreement which you are inferring -- we point out that in the last three or four years this moral suasion with the 7 per cent reserve has never come close to the 7 per cent. The banks have crowded -- and quite rightly so -- the 8 per cent cash reserve because that is where they make their extra remuneration. In other words, if a chartered bank were to run to 9 per cent primary reserve it would not make as much money as a bank that ran on an 8 per cent reserve. But when it comes to moral suasion, we feel that moral suasion over a long period of time is not the correct approach to either proper banking or proper finance.

THE CHAIRMAN: That is one aspect of it: Whether or not it should be statutory. But still I would like to know a little more abut why it is necessary to have any provision at all for that 7 per cent. There are the two views that are expressed, and there may not be much more to be said about it.

MR. BEATTY: In competition in business, Mr. Chairman, it is very frequently helpful to have some rule-of-thumb which enables you to tell your customer, "Much as I like you, beyond this point I cannot go."

COMMISSIONER BROWN: What is the context?

THE CHAIRMAN: I don't know that I am any wiser.

MR. BEATTY: If you have a 7 per cent requirement which you cannot go beyond, then it is easier to explain to your customer that you cannot serve his need at this time.

COMMISSIONER LEMAN: I think one should keep the very important fact in mind here that, moral suasion or not, the fact is that the bank has the right to vary the primary reserve. If the bank found the banks not keeping the right amount of secondary reserves, they always have the threat of moving the primary reserve, don't they?

MR. MILNER: That is correct, Mr. Leman. As I understand it, so far there has been no change ever in the primary reserve since it was inaugurated -- since a definite percentage was put on, and we merely suggested that rather than having a moral suasion clause for the secondary, that surely the government could better operate the system by varying the primary reserve to some extent if necessary.

We just do not believe that moral suasion is the proper method of operating over a period of years. It could happen over a short period under stringent conditions such as existed a few years ago when the government did not want any more finance paper issued. At one time they did not want any non-essential buildings constructed, they used the moral suasion clause to ask the chartered banks not to lend money to non-necessary activities, but that did not remain in force over any particular period. This particular moral suasion has been in for --

MR. COX: Just about six years.

MR. MILNER: For six years we have had the same clause in the moral suasion.

COMMISSIONER BROWN: We have some things to say about moral suasion as such later on and I think we would rather deal with them in that context.

MR. MILNER: All right.

COMMISSIONER BROWN: In this case I am speaking about secondary reserves.

MR. COX: Mr. Brown, I have found what I was looking for, C.88 and it comes under a matter requiring further examination and discussion. It says:

> "The Commission might examine whether chartered bank secondary reserves which were instituted through moral suasion in 1956, should continue to remain in effect."

I do not think that is a recommendation.

COMMISSIONER BROWN: Well, what is this recommendation 26? I wonder if we might move along. In B.25 reference is made to the way in which the liquidity on ease of market ability of long term Canadas has declined and the implication is there that the previously prevailing yield spread between provincials and municipals relative to Canadas has narrowed. Would you care to comment on that?

MR. MILNER: Well, Mr. Brown, I think most of that was covered in the discussion before lunch where we were referring to the market for Canada bonds. Perhaps Mr. Ely would like to expound a bit further on it.

MR. ELY: As you wish. I think I pointed out the development that had taken place and that there was an attitude on the part of the investor both institutional and private to buy securities of provinces which gave a somewhat greater yield and through experience they had found it just as good as marketability goes if not better in some cases, and that the federal government had used up their retail market through the issue of savings loan bonds. The reason for that paragraph, I suppose, was that in the case of provincial securities there has been a more continuous and better market than there has been for long term federals probably due to the fact that there are sinking funds in every province and no sinking fund exists in the federal area.

COMMISSIONER BROWN: This brings up the

recommendation which comes up elsewhere about the question of sinking funds for federal bonds.

MR. ELY: That is right.

COMMISSIONER BROWN: Do you think this is a very material factor in the marketability and the liquidity of long term Canadas?

MR. ELY: Yes.

COMMISSIONER BROWN: Has this always had an effect on the liquidity of bonds? I would like to have your comments, for instance, on Bell Telephones.

MR. ELY: A little louder, Mr. Brown.

COMMISSIONER BROWN: I was wondering to what extent this sinking fund always has an effect on the marketability you mention. I am thinking of Bell Telephones where there is no sinking fund.

MR. MILNER: Mr. Brown, we believe that the Bell Telephone would have a better secondary market had they had a sinking fund but literally the institutions as a whole, that is, the insurance companies, trust companies, et cetera, prefer to purchase -- naturally they have an increase in return by so doing -- to purchase all corporation bonds with a sinking fund. A corporation sinking fund is the highest of all sinking funds excluding Bell Telephone but there is a continuous market through the sinking fund operation for corporate bonds and in the case of the provinces, the western provinces particularly, -- take Saskatchewan as an example. Saskatchewan had originally one of the worst credit ratings in Canada. When they reorganized their whole debt structure and put their

sinking fund down, the 3 per cent sinking fund has created a market for Saskatchewan bonds that, in our view, has been a wonderful attribute to the province and to the market as a whole.

Any sinking fund, if properly administered, acts as a secondary market if you want to call it such from the 1st of January to the 31st of December because sinking funds do not normally purchase all their requirements the first day and have no market afterwards. The properly administered sinking fund purchases their securities with the viewpointof maintaining their credit rating as high as is possible.

MR. SHAW: I wonder if you would want to restate the early part of your remark, Mr. Milner? I do not think you intended to say that Saskatchewan has one of the worst credit ratings.

MR. MILNER: No, I said originally it had one of the worst.

MR. SHAW: It came through to me without the word "original".

MR. ELY: I think we can resolve the question, as this is my part of the brief, by saying that the attitude of the investor is such that he is quite prepared to buy provincial, municipal and corporate securities where in many cases there is just as good a market and where the yeld is greater.

COMMISSIONER BROWN: Would I be correct in restating your point that the yield spread between provincials and Canadas is now on such a constant

basis that if there is marketability within that yield spread that you might as well have the benefit of the greater yield?

MR. ELY: That is right. Sometimes the market for Dominion of Canada bonds has been put to a level one way or the other that perhaps does not sometimes suit the investor but there is no such things that work with provincial bonds. They work in a completely free private market.

COMMISSIONER MacKEEN: Do you see, Mr. Ely, a situation where it might react against the borrower having a sinking fund? I am referring to the case of private placement where there are perhaps half a dozen or a dozen institutions owning bonds and then no matter what the interest rate might be the bonds are not available below the call price for sinking fund purposes.

MR. ELY: That has been the case, Mr. MacKeen.

COMMISSIONER MacKEEN: It is rather a grievous situation from the borrower's point of view.

MR. ELY: It does not happen too often but it is an onerous situation on the borrower if market conditions have carried the price down and they cannot buy them. I think they should give some consideration also to the man who lends them the money at that low rate and they can always call them.

COMMISSIONER MacKEEN: They can call a 4 per cent at 1.05, for instance.

MR.ELY: That is right.

COMMISSIONER MacKEEN: Twenty years.

MR. ELY: Yes.

MR. MILNER: That was the penalty, Mr. MacKeen, of the borrower at the time of the issue deciding that he would sooner pay 4 per cent rate privately than he would a $4\frac{1}{4}$ per cent rate publicly. The cost of a private placement -- this, of course, is more true particularly in the American market where there is a huge amount of private placement and you have situations there where they are calling a 3 per cent bond at 1.03 merely because they are only owned by one person.

COMMISSIONER BROWN: I think if we can get back to the discussion of the operation of the Canada market. In C.21 there is a reference to the fact that the Bank of Canada has consistently under-estimated the psychological effect of its market operations which periodically has created excessive speculation and something resembling panic. We touched on this this morning but I wonder if we could have a little further discussion on just what is meant by this. Is this a matter of operation by the Bank of Canada, the way they operate?

MR. COX: I think it perhaps stems from that from time to time, but I have a feeling that while they must realize it they tend to disregard the fact that the Bank of Canada is not an investor in the sense that insurance companies, banks, et cetera,

are investors. They are not looking for a return of their money; they only own securities as a result of having changed monetary policy or to enable them to change monetary policy and as the biggest factor in the market when they start doing something everybody tries to figure out what they are trying to do. Perhaps undue stress is placed upon what might be a very innocuous little operation on one of the government accounts and it becomes interpreted as a major change in monetary policy.

COMMISSIONER BROWN: Would you like to go on and discuss the problems that occur, if there are such problems, in the operation of Canadian desks, both in Montreal and Toronto?

MR. COX: I think we tend to feel that the trading departments in both Montreal and Toronto are not large enough and I think usually a dealer cannot reach the trader because there is usually only one in the city and has to wait for a call back. He wants to do something right away. The fellow undertakes to call him back. He is not given enough discretion and it seems to periodically create a situation where a trader gets an additional sale if he does not call you up in an hour he is not going to do it. He is probably off his bid or off his offer and this seems to spread into the whole trading community and everybody starts testing the bank to see if they are there or not and you have got this situation where a dealer may have one million and sell you a quarter and give you a quarter of a million,

and a quarter of a million from somebody else and he is paying a higher price to another dealer. This seems to be unnecessarily complicated. Perhaps somebody else would like to comment on this matter.

MR. MILNER: I think Mr. Hunter would like to comment on this.

MR. HUNTER: Well, it gets back to what was mentioned this morning, that the Bank of Canada during the past few years has been the focal point in the market for government of Canada securities. Nobody wants to make a move until he finds out what the bank does. The trader goes in and makes an offer at the level at which he thinks the bank is and the trader there says: " I will have to let you know" and it might be necessary for him sometimes -- sometimes it is reasonably fast, it might be 15 or 20 minutes or it may be as long as two to three hours. Now, what do you do in the meantime? Do you just sit and wait? By this time everybody gets a little tense and wonders what should be done. This is the sort of situation that is created in the street and by the time the first dealer is able to sell a few bonds there are half a dozen other dealers in selling because they feel there is this development occurring and all this accelerates along the line.

COMMISSIONER BROWN: How do you suggest this should be improved?

MR. HUNTER: We suggested this morning that the Bank of Canada should not operate in the long

term market and possibly that is the most definite answer.

COMMISSIONER BROWN: I gathered there was a difference of opinion that some people felt that they should. Among those that felt that the Bank of Canada should operate how could this be improved?

MR. ELY: I thought they should operate in the long term market. I completely agree with Mr. Cox and Mr. Hunter that it could be improved and improvement would come about through more Bank of Canada traders in both markets and more authority so that they could act properly and there would not be this confusion and there would not be a time lag that creates what Mr. Hunter said.

MR. WADDS: Mr. Brown, the solution that comes to mind that may or may not be practical is if they removed the trading operations completely from Montreal and Toronto and put them in Ottawa and had a bunch of open lines into Montreal and Toronto. The authority for their operations all comes from Ottawa anyway and from a mechanical standpoint our trading departments could pick up a telephone and get the trader in Ottawa where the authority is. I thought that would eliminate a lot of this delay.

MR. HUNTER: I do not know if we are competent to advise the Bank of Canada how they should direct their trading operations because it may not refer to their actual operations at all; it

may be a matter that they are dealing with their problems in regard to the monetary picture. They may be making a decision as to whether they want to move it up or not.

COMMISSIONER BROWN: There is nothing about the mechanics of it.

MR. HUNTER: But I am suggesting the mechanics themselves might not be completely at fault. It might be those at the bank who could not make decisions for certain reasons.

COMMISSIONER BROWN: There appear to be two areas in which in your opinion there should be improvement. One is decisions and the other is the mechanical operation of getting in touch with people and getting word back again. We have heard a suggestion that instead of performing both monetary --

MR. HUNTER: It is purely a personal opinion.

MR. MILNER: Mr. Brown, if I might just put this. The opinion of most of our members, that is, who are really actively trading in government issues is that the Bank of Canada security department as such is definitely understaffed. It must be understaffed on account of the time lag that occurs. The in between -- normally a dealer in securities, if you want to call it the street dealer -- you can get immediate answer on the telephone as to whether you are willing to buy or sell a security and the frustration occurs, the delay occurs when the Bank of Canada, as Mr. Cox and Mr. Hunter have said, will say: "We will have to telephone you back."

As Mr. Cox said, it could be a bank policy, but we are under the impression that there is not sufficient authority given to the people who are contacting dealers on the telephone. Before stating that as a fact I would like Mr. Harris to express his views.

MR. HARRIS: I am thinking of the money market again.

These delays are often more important when you get down to shorter bonds, and the same thing occurs there. I think the money market dealers have largely eliminated the problem between Toronto and Montreal. The dealers have direct lines between the two cities. We move large amounts very quickly, but under many circumstances the bank system often moves on short-term securities. The Bank of Canada has a very important role in the money market. Certainly it does not intend to operate in the short-term money market in most cases.

These delays of some periods are often serious. The problem is that one trader usually in Montreal and Toronto deals with the money market and long-term securities both. If the trader is absolutely fully engaged all the time he has no chance to sound the market out at all. I think this is a problem also. The trader does not have the time to talk to the banks and dealers in a general way so as to know what is going on, and know what the other factors are in the market, and to know what sort of rumours are in the air in regard to possible other financing which may affect the rates on this type of thing. I think quite honestly

within both centres of Toronto and Montreal they know what factors are taking place in the markets more than they did. I think the dealers are in contact with Ottawa. They have often informed us of conversations. They are not right in contact. This is again a problem in the money market. There is certainly not enough attention paid to the particular money market policy and the speed required in these centres.

COMMISSIONER BROWN: Is there any criticism implied or otherwise regarding the skill of the persons employed?

MR. MILNER: No. I think, Mr. Brown, the criticism, if you might term it such, and I think if you were to question the chartered banks you would find the same reaction there--because they desire to act quickly and because of necessity they must at certain times--that the inefficiency, if you want to term it as such, is a result of their being under-staffed. There is literally, in our opinion, not a large enough staff. We think that the Bank of Canada marketing operations are under-staffed.

COMMISSIONER BROWN: In regard to the question of debt policy, you suggest that the national debt should be held by as great a number of individuals, institutions and corporations as possible. I think that statement appears in Section B, paragraph 22. What are the advantages of this wide distribution in the field of debt management, and the effect on monetary policy?

MR. SHAW: Is this question directed to me?

MR. MILNER: Yes, would you answer that.

MR. SHAW: The first question is, what are the advantages of the wide distribution of holders of government debt?

COMMISSIONER BROWN: Yes. The American federal debt does not seem to be as widely distributed in terms of indivduals so far, as compared to Canada.

MR. ELY: This is a section that I wrote, Mr. Brown. I think perhaps I should answer the question.

MR. SHAW: Yes.

COMMISSIONER BROWN: I am not going to allocate the queston, that is up to Mr. Milner.

MR. ELY: The question is directed toward a portion of the brief for which I am responsible. I said the national debt should be held by as great a number of indivduals, institutions and corporations as possible. The reason for saying that is this. The greater number of people that own federal securities; one, the greater interest they will take in the country; and two, the broader and deeper the market will be for the instrument that the government used to raise this money. In my opinion those are both sound reasons why this should happen to the greatest extent possible.

COMMISSIONER BROWN: We seem to have had indications also, and I think this appears elsewhere in the brief, that individuals particularly buy federal securities with the idea of security of principal.

MR. ELY: That is right.

COMMISSIONER BROWN: And of marketability?

MR. ELY: That is right. This is something that

we should strive to attain. It is not something that is presently in existence.

COMMISSIONER BROWN: The thing I am trying to get at is your thinking that if monetary policy is going to have an effect these bonds are going to change in price.

MR. ELY: That is right.

COMMISSIONER BROWN: And therefore the individual must get educated, must he?

MR. ELY: Yes.

COMMISSIONER BROWN: To the fact that his bonds are going to change in price?

MR. ELY: Yes, but if he is an investor that does not make much difference to the Dominion of Canada bonds.

THE CHAIRMAN: It makes a difference if he has to sell the bond all of a sudden for some reason?

MR. ELY: Yes, he has the opportunity.

THE CHAIRMAN: If the price of the bond is down on the market he may not be encouraged to buy another bond in the future.

MR. ELY: He may also be not encouraged to sell at a time when it is probably wise to have that money invested rather than spent when the economy is under pressure.

MR. SHAW: I think I see the Chairman's point of view. Harkening back to our Victory Loan bonds and subsequently, under the most intense kind of publicity or propaganda promotion, if you like, we induced the public to invest its savings in the highest quality

of security available, and we put forward the suggestion that if you do this you defer these needs of yours until some time later, and always you are going to be able to convert it into cash. We also use the argument here that if you have a sudden need for money it is almost as if you had money in the bank. I think your suggestion was that there are dangers involved. First a kind of danger arises when a great many individuals having been induced to entrust their savings into this particular instrument or type of investment, and the value of these investments declines and the purchasing power of the income derived from them declines; that in itself may create problems. Unless, Mr. Brown, you were thinking also of the lack of effectiveness in monetary policy if your debt is spread out over a great many individuals in a wide area where you cannot get at it, reducing the buying and selling of government bonds. That danger I would think is minimal because we now have a large enough body of short-term investment in the banking system to permit us not to have monetary policy diluted by wide ownership.

COMMISSIONER BROWN: I was wondering if you would also care to comment on the extent to which Canada savings bonds are impinging on what would be the normal market, or the otherwise market, I should say, for fixed income federal bonds.

MR. MILNER: I would like to answer that question, Mr. Brown.

When the war was over the government and the Bank of Canada at that time were intensely interested

in maintaining these savings that they had induced through the purchase of Victory loans. They tried to find an instrument that would be compatible with keeping public interest in our securities. Before going any further, as far as I am concerned, I think that to compare our position with the United States is erroneous to start with. The American nation is a supplier of world capital. We are a borrower of capital, or have been over the past generation as a growing country. So that the American debt structure I do not think can be compared with ours. I think that our debt structure, with our huge amount of debt distributed in the hands of the public, is a far safer factor for a borrowing country than the American system of having it concentrated in a limited number of sources.

To go back to the Canada Savings question, they were brought out shortly after -- I forget when the first issue was, but shortly after the war. They were brought out to encourage the continuance of savings among, if you want to call it, the working class people; the labour population of the country. I refer to the big labour force involved in the large industrial plants, and through the efforts largely of members of our association who covered all those plants, they were able to persuade the industrial companies to assist in the canvassing of their employees on a continuous basis, having an annual Canada Savings loan on which the money was absolute. Any time the money was needed it could be turned in at 100 cents on the

dollar. Added to that they wanted to encourage the normal thrift of citizens at large who were not working in the big industrial plants.

They started off at a limit of $2,000 in savings loans. We as an industry are thoroughly in acoord with the principle of Canada Savings bonds. Where we disagree with the government is that we think the government in the last few years has tended to make it a borrowing situation rather than a savings situation. When they raised the amount to $20,000 per person it was obviously no longer a savings situation. People do not save $20,000.

COMMISSIONER BROWN: Not even among the investment dealers?

MR. MILNER: Except some of the wealthier ones.

It became a means of raising money. We do not think that the government should raise money through call money at a high rate of interest such as has been obtainable in Canada Savings loans, because these loans originated for the purpose of supplying savings instruments.

We were talking either yesterday or this morning about the fact that this has been copied to some extent by our provinces who decided this was a lovely way of raising money. It has now gone to our municipalities. We have got treasury bills in nearly all of our large cities, and it has even got down to practically the villages which are willing to borrow money on short-term bases. That was call money on

short-term bases.

All we have said in our brief in respect to Canada Savings bonds is that we do not believe it should ever be used as a money raising device, but should be confined to a savings device.

THE CHAIRMAN: May it partly be due to the fact that people were reluctant to buy bonds when they found that they might have to sell at a loss, whereas in respect to savings bonds they are sure of getting their capital back? Is that not one of the advantages?

MR. MILNER: I think, Your HOnour, to some extent that is probably true, but I think we have developed an image over the past 10 or 15 years, and the nation as a whole is investing a large portion of its savings annually in Canada Savings bonds. I am speaking of purely savings. Whether it be against purchasing a house two years from now or not makes no difference.

THE CHAIRMAN: I say, this is an attraction?

MR. MILNER: There is an attraction.

THE CHAIRMAN: Particularly in respect to individual investments.

MR. SHAW: It is a defence against the experience in some of the market issues.

THE CHAIRMAN: Yes.

COMMISSIONER BROWN: My question was, to what extent do you think this inhibited the Government of Canada borrowing on a long-term basis.

MR. MILNER: I think I am speaking for our

whole industry when I say that we believe that if the limit of the available purchase is confined to a reasonable amount that it does not affect the ability to borrow long-term but, mind you, it must take off, of necessity, some of the short-term money. By and large the people who purchase Canada Savings bonds are not the same people who purchase long-term securities, to a marked degree. They are when you get up to $10,000 or $20,000.

COMMISSIONER BROWN: My question, to what extent do you think that the issue of Canada Savings bonds in recent years has inhibited the federal government from borrowing on a long-term basis? Has it had any, and if so, to what extent?

MR. MILNER: To a considerable degree. My own personal view is that $5,000 is the absolute limit that should be permitted in Canada Savings bonds.

COMMISSIONER BROWN: Then is it your suggestion that all sales to individuals of above $5,000 might have been put into longer-term bonds?

MR. MILNER: No, I do not think so, Mr. Brown. I do not know what the proportion is, but even call it 50 per cent; that might have gone into long-term bonds. It certainly is not 100 per cent, or not even close to that. If you look at the results of Canada Savings bonds sales you will see that payroll savings represents the biggest amount in these bonds.

COMMISSIONER BROWN: What I am trying to get at is, you criticize this way of raising money for the government. My question is, if it did not raise

this money, what proportion of it might have been raised through straight term debt securities?

MR. MILNER: I would say 15 per cent, possibly.

COMMISSIONER BROWN: Then it has not been a big factor?

MR. MILNER: In preventing long-term, no.

COMMISSIONER BROWN: So it has raised money for the government that would not otherwise have been raised?

MR. MILNER: I think they used this as a money-raising device, and at this high limit it definitely took it away from the savings aspect. It was no longer a savings bond, it was an investment. The establishment of the $20,000 limit has affected the ability of the Province of Quebec to distribute securities. Why would anyone purchase a Province of Quebec security if he could buy a Canada Savings bond guaranteeing 100 cents on the dollar at any time of the day or night?

MR. ELY: May I speak in this regard?

I think the Canada Savings loan issues have to a very marked degree usurped the market of other worthy borrowers, and have taught them to buy something which is very favourable in their hands, but it has certainly taken the market away from other people who wish to borrow. Is that what you are trying to ask?

COMMISSIONER BROWN: Yes, but I am also asking, how would the federal government have raised the same amount of money on a straight term loan? Apparently not through the same feature.

MR. BEATTY: To some extent through the same way.

COMMISSIONER BROWN: The answer was 15 per cent.

MR. ELY: My view would be that in the days of the original inception it would be a great deal more than 15 per cent. As the public has been educated to buy Canada Savings bonds over a period of 14 years the percentage has gone down, but had this instrument not been used to the extent it has been, as a major money raising vehicle, the other market that they took over by issuing savings bonds would have been large enough to have financed the government's normal requirements.

COMMISSIONER BROWN: The next question is, in the current market what sort of a rate do you think should be put on Canada Savings bonds in respect to this payroll savings feature that you discussed earlier?

MR. ELY: In the current market?

MR. MILNER: You mean today's market?

COMMISSIONER BROWN: Yes. What I am trying to get at is, to what extent do you think the interest rate is a factor in payroll savings plans?

MR. SHAW: It has to be sufficiently above the rate that would be obtained on savings deposits to attract into this vehicle, as against leaving it in the bank. It should not go beyond what a test would show to be a sufficient incentive to persuade the individual -- the man on a payroll savings plan or what have you -- to accumulate savings in this way.

COMMISSIONER BROWN: I am asking you to guess at the appropriate level.

MR. SHAW: The appropriate level, if they were doing it now?

COMMISSIONER BROWN: I refer to the payroll level.

MR. ELY: Oh, I would say 5 per cent.

MR. HUNTER: I think that is too high. I think that has been one of the problems in regard to Canada Savings bonds. Not only have they increased in size, they have made the rate comparable to the rate of a public issue. This is a wonderful instrument for anyone to buy. Any individual who can find $10,000 a year to invest would find no incentive to invest any place else because he gets virtually the same rate from Canada Savings bonds as he would on the open market. I think if the individual is getting the privilege of getting his securities in savings bonds he should expect a lesser rate. From an imperial savings point of view, my feeling would be that a 4 per cent rate is all that should be offered for these bonds.

MR. SHAW: Now, or when the 5 per cent rate was first introduced? In relation to the price on the market perhaps it is more realistic.

MR. HUNTER: I think they have got it out of line. I think they went too far with the rate.

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MR. ELY: By and large the rate that they have issued Canada savings loan bonds on has usually been -- I think you will agree -- at one-quarter of one per cent less than that.

MR. HUNTER: I would say that is about right.

MR. ELY: On other term Canada issues?

MR. HUNTER: That is right.

MR. ELY: Now, today when I was trying to measure the five per cent as of now, I am measuring it against the value of long term Canada as of now, and that rate is probably 5.65 or 5.70.

COMMISSIONER BROWN: I think what I am trying to get at is that there are two elements in the Canada savings bonds and I believe I understood from Mr. Milner's remarks that he is in favour of this on the payroll end of it.

MR. MILNER: That is right.

COMMISSIONER BROWN: That type of saving, but not so much in favour of being in competition with what could be normal market/securities. My question is, could you estimate an opinion as to how important the interest rate structure is in this payroll part of the operation?

MR. HUNTER: I do not think it is very important at all.

MR. ELY: Not as important if they are only going that far, and that is why I suggested perhaps today you could get three-quarters of a point away from the existing yields of other Canadas, whereas

they use a level of about one-quarter of a percent away. You might even go further.

COMMISSIONER BROWN: One further question on this. Do you consider that the general level of the Canadian savings bonds interest rates has been too high?

MR. ELY: They could not have raised the amount of money they have raised had they had it at a lower level.

COMMISSIONER BROWN: Thank you. Now, you make a recommendation and this is 21 and 22.

MR. SHAW: What section?

COMMISSIONER BROWN: I am sorry, I beg your pardon. That is not the one, it is recommendation 10:

> "...that a standing committee composed of men from The Investment Dealers' Association of Canada having experience and independent judgment in the marketing of Government of Canada bonds be established by Government decree to act in an advisory capacity to the Bank Of Canada and the Department of Finance in connection with such matters as the marketing of Government of Canada issues and open market and trading operations."

MR. MILNER: I will ask Mr. Cox to speak to that.

MR. COX: We think that both the Department and the Bank could benefit from additional information. I do not think that any of us have the idea that this committee would be absolutely perfect to the nth degree in the advice they are able to provide either to the Bank or the Department, but frequently two heads are better than one, and to the extent it was composed of, say, dealers -- we are the people who are contacting the accounts and will be doing the business -- and bankers who are people who have some idea what the situation is and I think that firsthand knowledge is better than something a bank may or may not have picked up, and considerable use of this sort of committee is made by both the Federal reserve and the treasury department in the States and we think perhaps it is worth a try.

Do you have anything further on that?

MR. ELY: I am in complete agreement with you, Mr. Cox and I would like to say something else on this, that in effect this is going on now, but it is going on on a hit or miss basis by various telephone calls that may or may not be initiated in Ottawa or in Montreal and we think that it should be focused properly and the government could get better advise.

COMMISSIONER BROWN: Who would choose the personnel?

MR. ELY: I think the only people that can choose it, really, are the finance department in consultation with the Bank of Canada because they

know -- those two areas know the people with the best knowledge, and it should not be chosen on a regional basis or anything like that, it should be chosen purely on a matter of knowledge and ability, and they have the ability to choose these men.

COMMISSIONER BROWN: Do you think they should meet regularly?

MR. ELY: I would think that they should meet at regular intervals and at several times when they have in mind doing some financing. This is the sort of thing that goes on in United States; they have a standing committee and they go to Washington and it has worked very well, I understand.

THE CHAIRMAN: It would be somewhat similar to the relationship between the provincial government and the syndicate?

MR. ELY: That is right.

THE CHAIRMAN: It would be the same type.

MR. ELY: We have never brought provincial issues to the market; the industry have never brought the provincial issue to the market to my knowledge without having prior consultation with what we like to call a steering committee, and that steering committee is made up of the knowledgeable people in the syndicate involved. The same technique could be applied in the federal area because it has worked and you can see the results of it in the marketplace.

COMMISSIONER GIBSON: And what would you talk about? Would there be general conversations about

the state of the financial system, specifically the bond market?

MR. ELY: There would be general conferences on the state of the market and they would certainly probably not pinpoint a specific issue at a specific price but the Committee could certainly give advice to the federal government on how much, what terms, what terms in matters of price -- they could give them amounts, price and maturities that would allow the government to choose which issues they would be wise to finance in and without disclosing the exact issue to the committee who should not have that knowledge.

COMMISSIONER GIBSON: Suppose that there were considerable differences of view amongst the men?

MR. MILNER: That, Mr. Gibson, is the reason we think there should be a committee. We believe that the present system which is used today by the Bank of Canada in consulting, if you like -- a dozen different dealers individually, we believe that collectively three or four people could give far better advice around a table than with the advice you get from six or seven individuals.

MR. ELY: Might I enlarge on that by saying that you would be surprised to find in a so-called steering committee on a provincial issue that there has never been to my knowledge a considerable divergency of opinion, never. It is amazing how accurately that kind of a committee can measure various

areas of the market both as to volume and price.

COMMISSIONER GIBSON: But would not a discussion of this kind reveal to you what the government had in mind?

MR. ELY: If it was held quarterly then it would have no significance on when the government might come to the market. If it was held immediately prior to the government issue and it was obvious that it would have to refund that issue because it did not have enough working capital, then I think the discussions should take place on such a plane that it would not be disclosed to those people in what area they were going to do their financing.

MR. WADDS: Could I say something? In the United States this committee is called in Washington prior to every major piece of financing that the government does. As you know, there has never been any question of a leak of information, and what goes on at those meetings I have no idea and I do not think anybody else has, except the people that go to them and I think that system could work quite effectively here. This, for the record, is another attempt which we would like to make to develop a better liaison between the issuing body and the ultimate buyer and we are in touch with all the people who buy securities and this would make it simple for the Department of Finance to cover this type of knowledge with the people in the field. I think it would be very useful.

COMMISSIONER HARROLD: You make certain

recommendations concerning the Board of Directors of the Bank of Canada in recommendations numbers 21 and 22 on page 6. The first question would be, would you not think if these recommendations were carried out, that at this executive committee would have approximately the same kind of advice to offer as you would get from the committee that you are suggesting for the Department of Finance.

MR. BEATTY: Mr. Cox, would you speak on that, for a minute?

MR. COX: I think, sir, the problem has been that the appointment of directors to the Bank of Canada have become a little too political and they are not necessarily chosen on the basis of their education, the kind of work they do, and there is the specific exclusion of bankers, which is not the case in the Bank of England or the federal reserve, and it seems that if the Board is to be of any help to the Governor and his senior personnel in arriving at policy decisions, it would be considerably better if these men did have a financial background, either educationally or from the type of work they do.

COMMISSIONER HARROLD: That meets with your suggestion in Section C.19 in which you say "useful guidance".

MR. COX: Yes. I have never attended one of the meetings and I do not know what goes on, but there are so few people who would appear to be able to have sufficient knowledge to give any advice or guidance to the Governor on what was a pretty highly

technical field.

It may be that people will advise him on how business conditions are in the provinces which they come from, or what the outlook is for the potato crop, or something like that; this is important, but it will not help the banks in arriving at a policy that will fit the needs of the economic situation at the time.

COMMISSIONER HARROLD: I agree there are times when potatoes may be important, but as to the number you have there, would you change the number from the present twelve?

MR. COX: That is something I had not thought about. It seems enough, does it not?

MR. ELY: Are there twelve?

MR. COX: There are twelve now, I believe.

MR. ELY: I think that is right. I do not think this is a question of having a large number, I think it is a question of having a board that are skilled to give the Governor advice and now it seems as though they are chosen regionally rather than for ability. I do not mean they have not got ability, but they are chosen regionally by provinces but it might be better if they were to have them all come from two or three provinces and they can find the right men. The men are available.

COMMISSIONER HARROLD: But are they not to be from diversified occupations even if they do come from the different provinces?

MR. ELY: It seems as though there is a certain number per province, but no matter; certainly if the Act reads that they come from diversified industries perhaps that is a worthy reason, but I think they could probably find a better answer to that by making it a man with knowledge of financial affairs in the country so that they could get better advice for the bank.

COMMISSIONER HARROLD: How long has the change in personnel, then -- you suggest that the directors would have more control than they have at the present time, or do you still suggest that the Governor would have the power to control?

MR. MILNER: Mr. Harrold, I do not think you can ever have a central bank operate without a governor having the power of veto, but he would be so subject to advice that you would question whether the power of veto would ever occur. It is really the same recommendation as we have got for the advice on the issuance of new securities. In other words, that there is somebody to consult outside his own immediate circle who would be competent to give them better advice than they are getting now under existing circumstances. I could not conceive of the executive committee of the Bank of Canada meeting -- we suggest that they meet fortnightly.

COMMISSIONER HARROLD: Do you know how often they meet now?

MR. HARRIS: I think it is eight times a year.

COMMISSIONER HARROLD: The executives?

MR. MILNER: The executive committee is only one man -- oh, are there two now?

MR. WADDS: The deputy minister and one director, I believe.

COMMISSIONER HARROLD: You would not find included officials and directors of banks, chartered banks or employees?

MR. COX: I do not know why we should.

MR. MILNER: We do not believe that -- we are trying to get away from anything political in so far as banking is concerned, and the calibre of person who has risen to the rank of general manager or bank's president or president of a bank, or important industrial people are beyond politics, in our view. We think in this way we would have an impartial opinion of what they think is good for the country, if you have the right people on the board and I think to exclude the chartered banks' representatives would be fatal. It would be fatal not to include them in that category.

COMMISSIONER GIBSON: Mr. Milner, how could you just envisage a group of people like this; some skilled investment dealers and bankers talking about things that in any event might not accommodate their own interests. How would you do this? That is, if they are still fully occupied in their regular jobs?

MR. MILNER: It has worked in other countries, Mr. Gibson.

MR. SHAW: Well, in the present system is it not true that some of the existing or preceding governors have been connected with business enterprises where the same concern might not have arisen?

COMMISSIONER HARROLD: There was a case of central bank officers and the senior top officers coming from other groups where their interests are conflicting with the central bank and they are acting as advisors to the Governor of the central bank.

MR. SHAW: My question was, going back over the past directors, isn't the case that we could find amongst those people people who, if we retraced their business connections, where you would find the decisions made by that board could have a serious impact or effect upon the businesses with which they were connected, and yet that has not precluded them from being on the board before.

COMMISSIONER GIBSON: I don't think you would find any bankers or investment dealers.

MR. WADDS: You will find a senior director of an insurance company who is a director, where there could have been an effect by the bank's action.

MR. HARRIS: The Bank of England, the directors there are merchant bankers and commercial bankers to a large degree, and there was an enquiry some time ago, and it came out there was no problem at all.

COMMISSIONER BROWN: Except they do not have anybody from the clearing banks. They are all from the smaller institutions.

MR. HARRIS: Merchant banks.

COMMISSIONER BROWN: Yes, merchant banks.

THE CHAIRMAN: What about the Federal Reserve? They are all full-time directors there.

MR. COX: Each of the twelve district federal reserve banks has three classes of directors: Two of those three classes are chosen from bankers in the area in which the particular bank has jurisdiction, and the presidents of all those banks form the board; the board of governors of the Federal Reserve system is

selected from these twelve.

THE CHAIRMAN: The Board of the Governors of the Federal Reserve are full-time governors?

MR. COX: Yes.

THE CHAIRMAN: They are not carrying on any of their former business; they cut adrift from their former business associations?

MR. COX: But that is not true of the directors of the District Federal Reserve banks.

THE CHAIRMAN: Oh, no. The policy is directed from the board of governors.

MR. COX: Yes, but they get their information from bankers.

THE CHAIRMAN: I have often wondered why it is necessary to exclude certain segments of the business community who probably know more about the problems involved than anybody else just because there might be conceivably a conflict of interests. Business is full of conflicts of interest. Directors of banks have frequently conflicts of interest between their business, but they have to go outside the door and pretend they don't know anything about it. In all corporate business, directors frequently have conflicts of interest and they simply have to declare their interests and refrain from voting, if it involves a conflict. But, it seems to me -- and I am just thinking aloud here -- if you gentlemen have any opinion to express as to broadening the field from which directors of the central bank can be drawn so that there would be a much greater infusion of highly qualified people in this particular field.

MR. COX: That is what we feel.

THE CHAIRMAN: As well as having representatives from other lines of business, because that also is very important, but at the present time there is complete exclusion of anybody who is really qualified in the field unless he happens to be a retired banker. I think there is a great loss there, myself.

MR. ELY: I think we as an industry feel that too.

COMMISSIONER HARROLD: Have you gone so far as to suggest there should be full-time directors?

MR. MILNER: Not in our brief, we haven't.

COMMISSIONER HARROLD: I should have put it in the form of a question.

MR. COX: I think I would like to think about that one. I don't know whether it is necessary to have all full-time attend the meetings with the Department of Finance or the Bank of Canada. It might not be necessary, unless possibly the executive committee might be represented by a full-time person.

MR. ELY: A full-time director would immediately lose his usefulness by not working on anything else.

MR. SHAW: Some of his usefulness.

MR. ELY: Some of his usefulness, yes, that is better.

COMMISSIONER GIBSON: The problem here is that we get the impression from your memoranda and recommendations that you would like to have a more active board that would take a more aggressive part in formulating monetary policy. In other words, not a

board of directors that pass on the more or less corporate things that go through, but a board that is actively engaged in thinking about and formulating monetary policy. This is why I raised the question of conflict of interest. If it is the kind of board which functions the way the present board does, it does not appear the conflict will be serious, and in the Bank of England they do discuss these things -- some of the things where conflicts might arise don't get to this type of director. It is this question I am really thinking of.

MR.COX: I think our thinking is that any conflict of interest that might arise seems to be less serious than the Governor of the Bank lacking advice that might be useful to him.

MR. SHAW: Or some body on which he could try out his proposal; that would be the function, it would seem to me, the board would best serve. It would provide a body of knowledgeable people to whom the Governor could take the ideas he has formulated, and I would not see this as ideas originating within the board. They should still originate with the active governor and he in turn has someone to whom he could take these suggestions and work them over a bit before they become policy.

COMMISSIONER BROWN: What sort of decisions do you visualize being made?

MR. SHAW: I am thinking of changes in monetary measures that are being introduced. I think the decisions would be as to the measures themselves and as to the timing of them.

MR. COX: You get a practical opinion from somebody who is perhaps going to be affected by some of these changes as to what the effects are going to be.

COMMISSIONER GIBSON: Bearing in mind monetary policy is most of the time more of a flow than a series of disjointed and separate decisions, do you think this is really feasible? When you have a crisis you sit down and decide and make some very definite decisions, but most of the time isn't it a matter of guiding something-- moving a little this way and that way and feeling your way along, and in those circumstances can you use this kind of advice?

MR. BEATTY: Could not that crisis be avoided with proper outside assistance?

MR. MILNER: Put it another way, Mr. Gibson: Could not the Governor go to the government and say the advice of his executive is rather contrary to what the government opinion had in mind. I think you would accomplish a tremendous amount if you had the really top calibre of people in this country advising the central bank. I cannot help but feel it would be a constructive measure in the future of the country.

COMMISSIONER HARROLD: You see no need for any geographical or industry representation on this kind of board; is that right?

MR. MILNER: Well, Mr. Harrold, I think in picking a board -- of course, it is very difficult to pick a board, obviously -- but all that we put in our brief, or that we suggested, is that it be completely

divorced from a political board and completely divorced from a regional board; that is, not to have it automatically with somebody from New Brunswick, Manitoba, Saskatchewan and two from Ontario and so on. It would be picked by the manpower or the man ability rather than regional -- diversity of interest.

MR. COX: They should not all be bankers or all economists or all dealers.

MR. LEMAN: Mr. Gibson, if the inference is that it may not be desirable to have people with knowledge and experience in matters of finance and banking on the board of the Bank of Canada to advise the Governor, why have a board at all?

COMMISSIONER GIBSON: Well, we are asking you. I don't know.

COMMISSIONER BROWN: I think we should also say that I do not think at any stage has there been an inference that you should not have people with this experience and knowledge. There is an inference you should not place people, particularly people who have directly and obviously a conflict of interest in that position. I don't think there is any inference that type of person is not wanted.

COMM SSIONER GIBSON: There is no inference at all. This is the kind of problem that could arise, and we are trying to get your view.

MR. MILNER: I think we have said everything we have in mind.

COMMISSIONER HARROLD: In selecting this type of board what would be the end result -- where would they

come from? The financial community?

MR. MILNER: I would think, Mr. Harrold, that the prime people I would visualize, if you are talking of a board, let us say, of ten people, to use a number -- I would think you would want to get as much diversification as possible. You would want a banker, but industry would be the prime people that you would employ on the board. I think industry would rank the highest -- financial institutions: Put it on that basis.

--- Short recess.

THE CHAIRMAN: We will now resume.

COMMISSIONER GIBSON: Mr. Chairman, I would like to ask a question or so about moral suasion. You have made it clear to us, gentlemen, or some of you have, that you don't like moral suasion as a long-term operation. What do you think of the use of this instrument -- perhaps we should not even call it moral suasion. We will just call it "persuasion", and that would perhaps be more realistic. What do you think of the use of this kind of an implement in monetary policy? I understand from time to time you have encountered persuasion -- moral suasion. We would like to know whether you feel it is an effective instrument in monetary policy and whether it can be used too frequently, and so on?

MR. COX: I think it is highly desirable that the bank can make use of this kind of technique because I think it would be almost impossible to visualize an act for the bank which would cover all the things and all the contingencies that might arise from any sort of external or internal pressures. We have set out quite a

bit on what we know that the bank has done in this field, and it covers a pretty wide area, but I think it is very important that it should be made clear that short periods should be involved, and when the persuasion as such has served its purpose that whatever instructions, or whatever you want to call them, the Governor has issued to those concerned, that they be advised this emergency is now over and whatever they have been doing has served its purpose.

COMMISSIONER GIBSON: Do you feel it applies only to emergencies?

MR. COX: No, not necessarily emergencies; that is probably a bad word. It might be better to say, situations that require some sort of action.

COMMISSIONER GIBSON: Any sort of situation, or does it need to be a fairly serious one?

MR. COX: It depends on extent, I suppose, but I think it is desirable that the bank be able to go to some group who have some sort of control over some kind of credit and say, "You are overdoing it. Can you change your policy a little. This is not in the best interests of the country." I think, carrying it a step further, it may be interesting to pursue the thought that we have now had quite a few experiences of the use of moral suasion, and is there anything there that should be enacted that the bank should have legislative power over? For instance, reserves for near banks or terms of credit extension by finance companies, and what not. I would think perhaps this would be something that you would be looking into in your deliberations

later.

COMMISSIONER GIBSON: We will be glad to have your views.

MR. COX: I don't know that I am qualified to express any views as to whether the bank should have powers over anything specific in this area, but it is rather interesting that the Federal Reserve seems to have a number of these powers. On the other hand, the Bank of England seems to rely directly on moral suasion and does not seem to feel it needs an enactment. I don't know whether that represents the material of the market in which they are operating.

COMMISSIONER GIBSON: Are there any limits , apart from the time limit, that you feel ought to be applied to this technique?

You said earlier that you think if a thing goes on a long time it ought to be put in legislation. You said that in the context of the secondary reserve

MR. COX: What would you mean by limiting, Mr. Gibson?

COMMISSIONER GIBSON: Well, again I am not expressing an opinion; I am trying to create a situation that you can comment on. When somebody wants you to do something that you can see will be very much against your interests and you are the people who are asked to do this, some may do it and some may not. If it is just a little against your interests or if you can all agree that this is good in the national interest, does this problem arise to the same degree?

MR. COX: I think it would be most important that the governor's prestige is such that he could go to a group and present a convincing story and be successful in his efforts to persuade them to change their tactics. This, perhaps, raises the question that if he is going around every week asking people to do something perhaps he is overdoing it.

COMMISSIONER GIBSON: How far do you think he should go in asking people to go against what they conceive to be their self interest?

MR. COX: I think that would have to be his decision. This is something of an individual judgment, is it not?

COMMISSIONER GIBSON: Yes, but it is an important question.

MR. COX: It would have to be in the national interest, there is no doubt about that.

COMMISSIONER GIBSON: Clearly in the national interest?

MR. COX: I think pretty clearly.

COMMISSIONER GIBSON: So that nobody would recognize this?

MR. COX: Or it could be explained to them in such a way -- but I do not think he should threaten some sort of action to gain his ends.

THE CHAIRMAN: When you talk about persuasion or moral suasion it is really not that at all. In the background there is, although perhaps not in the open, an implicit possibility of a threat when the Governor of the Bank of Canada asks the chartered banks to do certain things at a certain time, is that not right?

COMMISSIONER GIBSON: Mr. Chairman, I was talking about this in the context of the relation between the Bank of Canada and the Investment Dealers.

MR. COX: Possibly there is, Mr. Porter.

THE CHAIRMAN: If the Governor of the Bank of Canada felt strongly enough about it and was determined that his proposal should be brought about he would be in a very strong position to go to the government and ask for necessary legislation and they all know that. The governor is not likely to ask for something of that kind unless he has good

reason from the national standpoint to do it. I would think it is not just a voluntary act on the part of the parties that are approached whether they are investment dealers or banks or whoever they may be.

MR.COX: Well, of course, this raises the point whether this threat of legislation would be desirable for the country on a permanent basis.

THE CHAIRMAN: Well, there is always that in the background. There is always the possible legislation. Very often people want to avoid that. They would rather comply with the suggestion for the time being in the hopes that perhaps in time conditions would change and it would be lifted?

MR. COX: Well, actually the way I was thinking of it is that he should go to the banks and say: "Look, you do this or I will change your cash reserves" or something. That is the kind of threat I was thinking of.

THE CHAIRMAN: No, he does not have to make a threat. No doubt he has very persuasive arguments but there is something always in the background and especially when matters emerge in which there is a national interest involved and people are approached most of them will accept the views of authorities that there is some national interest involved. If one individual decides to disobey the situation he knows perfectly well that something will happen.

MR. BEATTY: Not necessarily. In the case of the finance companies controlled from outside

of Canada I believe there was an instance where they did not co-operate and nothing was done.

COMMISSIONER BROWN: I think this clears up the point that unless there is some club hanging in the cupboard in the background it is more difficult for moral suasion to be effective?

COMMISSIONER GIBSON: I do think there are circumstances, Mr. Chairman, where different groups will recognize the national interest. I am sure the investment dealers would agree with anything that was suggested that might be in the national interest -- similarly with the banks, although there is the possibility of the use of power always there. I was just trying to get some idea of the ranges of this. The sort of impression I gathered from you was that it is not something continuing. You say partly in the nature of an emergency you think moral suasion is a good thing?

MR. COX: Yes.

COMMISSIONER GIBSON: And apart from that you do not?

MR. COX: That is right.

COMMISSIONER GIBSON: Do you run into this conflict of interest on moral suasion where some people will come in and adopt suggestions and others have not?

MR. COX: Not at first hand.

COMMISSIONER GIBSON: I mean in your industry?

MR. COX: Oh, I think we have. We have

definitely run into it in the case of the finance companies somebody mentioned.

MR. MILNER: We have had it also, Mr. Gibson, in our industry which comprises 190 odd dealers where we have been requested on a moral suasion basis to a very limited number of our members and the viewpoint of the government was, I assume quite correctly, that if you ever tried to publicize it to 191 people it would not work. You might as well make an act of it so that they get two, three, half a dozen people who were the most important people in that particular field but that did not prevent the 186 others from carrying on their normal transactions and I do not think any one of the people involved had any thought that they were not doing the right thing by taking the suggestion of the central bank if they did not do a certain transaction.

COMMISSIONER GIBSON: Perhaps another way of looking at this thing would be to ask you whether or not you are in favour of the use of directives and controls by the central bank if that is related to the question of moral suasion. This is sometimes an alternative.

MR. MILNER: Well, I can answer that, I think, without any difficulty. We would much prefer moral suasion than having direct control. We do not like controls if it is humanly possible to avoid them whether from the central bank or any other source. I believe our freedom of action in being left to our own judgment is far better than having legislation

which is so difficult to take off. Once it is on it tends to remain. Moral suasion is a far better method of accomplishing what the central bank may want.

COMMISSIONER GIBSON: I am thinking of selected credit controls actually.

COMMISSIONER BROWN: Such as the suggestion on page 27 of Section C.

MR. COX: This is a question of margin requirements in that case, sir. I think I would agree with Mr. Milner that if the Governor feels that something needs changing along the line of these examples, if he is able to do it through moral suasion that is perhaps better than giving him legislative powers.

COMMISSIONER GIBSON: You would rather do it informally than formally?

MR. COX: Yes.

COMMISSIONER GIBSON: Would you still say that if it would be a continuing problem?

MR. COX: Well, if it is a continuing problem then I think it becomes a question of legislation.

COMMISSIONER BROWN: I would just like one or two more fairly quick questions if I could get an answer. And this is in connection with the bill market. I wonder for the record if someone would care to outline the nature of the undertakings that are taken by the 14 members of the money market. What obligations do you undertake in exchange for this right?

MR. HARRIS: Tendering for treasury bills?

COMMISSIONER BROWN: No, anyone can tender on bills.

MR. HARRIS: No, a prime distributor cannot tender. You mean lines of credit?

COMMISSIONER BROWN: Yes.

MR. HARRIS: Well, the 14 lines of credit are in the central bank. They are given these lines first of all because they are dealers who have shown in the past that they are active and able to distribute enough obligations and have shown a responsibility. They have got the capital that allows them to participate in the money market. The money market men must have quite a bit of capital. I do not know if all terms given under the Bank of Canada are in the same form or not. The Bank of Canada has a pretty good idea of each firm's financial responsibility and I think the firms which have the privilege of rediscounting money market securities at the Bank of Canada realize this privilege and react accordingly and participate very actively in placing government securities. Is there anything more?

COMMISSIONER BROWN: Is there any obligation in connection with the treasury bill tenders?

MR. HARRIS: The actual bill tenders? There was a little while ago a moral suasion directive -- this is what you are after, I gather -- it was done in a very informal way. The dealers were allowed to tender for not less than 10 per cent of the treasury bills and not more than 25 per cent of the bills each week. This was to try and create some stability in the treasury bill market. Some directives,

I think, have been done more formally through letters to the firms with regard to the item we mentioned earlier for the dealer's line of discounting their bank rate from the chartered banks. This was going through the formal channel. This other was not. It was informal through a meeting with the money market traders and not with the senior heads of the firms, I believe, at that time.

Most firms have more or less abided by the not over 25 per cent, but recently I think in this crisis the 10 per cent has not been a very practical thing. People have bid for 10 per cent but some of the bids would be a way out of line. I think the bids are usually put in and scaled so that the bids are not very attractive. Does this answer the question?

COMMISSIONER BROWN: That is what I wanted.

MR. MILNER: The only other question, Mr. Brown, on that is that the 14 members report weekly to the Bank of Canada their position on the short term securities.

COMMISSIONER BROWN: I would like to bring out one other point and that is: is there a presumption that if somebody who is not now in that market wishes to develop an interest in this that he can become one of the money market group?

MR. HARRIS: The money market dealers, there has been quite a change over the years. Recently one firm joined during the last year and it seems to be

quite a flexible organization. This is up to the Bank of Canada and not the I.D.A. but it seems to be quite flexible and there have been many changes within the money market since its inception.

COMMISSIONER MACKINTOSH: I just wanted to add one point. Is there any suggestion of influencing your inventory through the short term money market instrument that you hold?

MR. MILNER: None whatsoever.

COMMISSIONER BROWN: On bankers' acceptances which I suppose we might say are almost stillborn.

MR. HARRIS: Well, about two week's life. They were introduced in theory June 9th at which time theoretically a person using an acceptance could borrow 5 per cent as against a primary of 5½ per cent and in theory now the acceptance is 6-3/4, 6-7/8 compared with a primary of 6 per cent. At the moment nothing has happened.

COMMISSIONER BROWN: The only question I was going to ask is, have you any comments on the $200,000 size?

MR. HARRIS: Well, from my several weeks of study and my personal point of view I found some of the people who were interested in acceptances were interested in amounts less than that size. I think the type of formula that they use an acceptance market for might be less than that. Acceptances are designed for self liquidating financing, warehousing and trades, and where in a single instance it is much more possible you want it over a period of time and

not on a particular day.

COMMISSIONER BROWN: What do you suggest would be more acceptable than the $200,000?

MR. HARRIS: Well, certainly $100,000 would bring more people into it. I think there is a problem of both the banks and the dealers on the paper work involved and I think $100,000 would be much more practical.

COMMISSIONER BROWN: One question on corporate paper and finance company paper. In June 1938 the comment was made that the dealer usually operates at a smaller commission than he would on finance paper and at first glance it seems a little odd because finance paper is on tap whereas this is a one shot effort, and one separate deal. Can you put on record why it is a smaller commission?

MR. HARRIS: Well, this came up through something we were discussing yesterday, competition within the industry to a degree. Corporate paper has indirect benefits to a dealer who conducts this account.

COMMISSIONER BROWN: You are servicing the account?

MR. HARRIS: You are servicing the account, you are doing a job for him, you are helping people you have long done financing for. You are in competition and dealing with firms that you have not had contact with so it has resulted over the past several years that the commissions usually have an edge on a permanent basis rather than finance paper.

COMMISSIONER BROWN: It is in the nature of a loss leader?

MR. HARRIS: No, I would not say that. If the volume was large enough during the year to make money on there is no problem there. Some of the demand paper is -- also I think the reason that is a loss leader it is only one firm and short term obligations. Those people at other times would be buying Canadas short term, they will not be buying finance paper on provincial obligations.

At one particular point they may want finance papers, and at other times they may want other obligations, and you have to service them in all fields, I think.

COMMISSIONER MACKINTOSH: I have one question that refers back to yesterday's discussion largely in respect to corporate securities. I would like to put this question in order to clear up the views that were expressed at that time.

Mr. Milner, would you think that the association, or a considerable proportion of its members would favour regulations under legislation of full and continuing disclosure as that is commonly understood by all the corporations issuing debtor and equity securities to the public?

MR. MILNER: Well, Dr. Mackintosh, we have had some discussions along that line of thought. A few of us have taken a look at the requirements of the New York Stock Exchange both as to listing and, more so, on continuous disclosure, and again in respect of certain of the facts we were gathering, such as takeover bonds, voting stocks and various other restrictions. It seems to me, speaking personally, that in Canada with only nine provinces instead of -- I don't know how many there are now; 51 or 52, or something like that.

COMMISSIONER MACKINTOSH: There are now10 in Canada.

MR. MILNER: I was getting the banks mixed up. With only 10 provinces, four provinces having practically identical securities regulations, that it would be well to consider such a system. How this could

be done legally I do not know. Whether this would necessitate federal legislation or whether you would have to have the combination of federal legislation and, using our old term, moral suasion with the provinces to change the regulations in respect to full disclosure and, more particularly, perpetual full disclosure annually on all securities that are held by the public, I do not know. It would start very simply with the three major stock exchanges. If the three major stock exchanges had, for instance, identical listing requirements that could not be varied to suit certain circumstances and, at the same time, if it were obligatory to publish quarterly earnings statements or, at the worst, half yearly earnings statements and annually to publish a proper digest of the operations of the company -- this is outside of their normal balance sheets that are issued -- so that the public could be informed as to what security it owned, whether it be a bond, a debenture or common stock, all carried to that extreme, and if the legislation governing the listings were made adequate, along with completely adequate provincial legislation providing that every company that had public shareholders would be forced to abide by the same set of rules, I think it would be the greatest step forward that could be taken, both for the protection of the public in the true sense of the word but, even more so, to strengthening the viewpoint of outside people -- that is non-resident people who would have a far better picture of our industrial development if such information were available. I do not know how it

could be done legally. We are completely at sea as to whether the securities acts could be superimposed from Ottawa, or whether they could not, but I would assume that for instance the Companies Act, which is federal legislation, actually has certain of these restrictions in it, but they have never been enforced and can only be enforced if somebody complains. Of course, the chances of an individual shareholder complaining are so negligible that companies are able to avoid disclosure in the normal course of events. I refer to full disclosure of course. I am sure that every one of our members would be in favour of the fullest disclosure that is possible, but I would like to have a couple of other people, if you do not mind, sir, make a few remarks in this regard.

COMMISSIONER MACKINTOSH: Let me interject here. At this point I am not interested in discussing whether you would do this by amending the Companies Act or by separate legislation, or what the technique would be. That would be a later thing. I am not interested at this point in your methods of enforcing this. I would like to clear in my own mind the question as to whether this group would feel that if this could be accomplished it would be a good thing and would support them in their various associations in carrying out what they think is proper.

MR. MILNER: Dr. Mackintosh, I was only speaking in this particular instance not as Chairman of this brief committee, but as an individual.

I would like to ask Mr. Beatty, if I may, if he

agrees with my premise. He could take it up at the association level and we could get you a very definite answer within a very short time.

COMMISSIONER MACKINTOSH: Fine.

MR. BEATTY: I feel confident that the members of the association would approve more complete disclosure if we can arrange it. I do not think it needs to be taken up at the association level.

MR. STRATHY: Dr. Mackintosh, perhaps this is a personal view as the result of vast experience which I have had in connection with the stock exchanges and I do not know whether you would like that, but I know that for the last number of years stock exchanges generally have hoped that there would be a method found whereby they could regulate their listing companies , and that full disclosure be defined in respect of listing stocks.

There has been a very difficult situation develop through the different rules that prevail on different stock exchanges. I am sure the will is there. Perhaps that gives a little broader viewpoint than just expressed by the I.D.A.

COMMISSIONER MACKINTOSH: Thank you.

Could I ask another question? I do not want to pursue this, but you are satisfied that while nobody could probably define literally what you call full disclosure, and someone a moment ago gave a more full description, you do feel that practically for the purpose of the regulations an acceptable definition of what would be full disclosure could be arrived at?

MR. STRATHY: I am sure it could be worked out.

COMMISSIONER MACKINTOSH: It could be arrived at?

MR. STRATHY: I am sure it could be worked out to the benefit and satisfaction of the requirements of the shareholders, giving them that information which I feel a lot of them think they should have.

COMMISSIONER MACKINTOSH: That satisfies my requirements, thank you.

THE CHAIRMAN: Would you be in a position to work out a definition of that kind which you would agree to as being adequate for the purposes? Would you be able to do that?

MR. STRATHY: I think it could be worked out.

THE CHAIRMAN: I do not mean right now. I mean, in due course perhaps you could send one to us that you think would be an adequate definition.

MR. STRATHY: I am quite sure it could be worked out. I am not sure whether it is within the prerogative of the stock exchanges, or whether it is perhaps a joint thing..

THE CHAIRMAN: I am not interested particularly in who does it.

MR. STRATHY: It could be worked out.

THE CHAIRMAN: Since you are before us and you have made this submission as to your views on the whole subject, perhaps you could produce a definition which satisfies you and the stock exchanges or anyone else you may feel should be consulted. Such a definition would help us.

MR. BEATTY: The mortgage people should be consulted.

THE CHAIRMAN: That is entirely up to you. If you could send such a definition in due course, and there is no great hurry about it, it would be of great assistance.

MR. BEATTY: We could consult with the exchanges.

MR. SHAW: This is the sort of question that could be developed when you hear from the exchanges, because it seems to me this is something that must be developed between the exchanges, ourselves and others.

THE CHAIRMAN: You may keep this in mind and in due course you will be in touch with us agin, I am sure, and you will be in touch with the exchanges.

MR. SHAW: Yes. The willingness is within our association to co-operate.

THE CHAIRMAN: It is easier for you to do this, and more satisfactory, than for us to do it.

COMMISSIONER MACKINTOSH: At any rate I am sure the advice of the association is available to us.

THE CHAIRMAN: Yes.

COMMISSIONER LEMAN: Mr. Chairman, I have a few loose ends to tie together. I would like to refer the witnesses to paragraph 12 of Section E where the point is made there in regard to corporate financing.

It is said in that paragraph that as shown by Table 3 on page 5 small firms have relatively more recourse to bank financing than the larger; debt constitutes a smaller proportion of capitalization (and much of the debt is represented by mortgages) and a

higher proportion of net profit is retained.

I am inclined to question that all these conclusions flow from an examination of Table 3. For instance, in respect to the retained earnings, which are about equivalent to what you call surplus in that table, except for the very small group of companies covered under $100,000 in total assets, the retained earnings do not seem to me to show a very great tendency to ascend with size. Would you agree with that?

MR. MILNER: Well, Mr. Leman, in answering that question you must realize that the Royal Commission on Finance has had a very tragic effect on the man that wrote this document for us. He put his back out this morning and is in bed. He has asked me to state that this was prepared completely by himself and one other firm in Montreal. I was wondering if it would be possible to have that gentleman give us the words he would like in answer, and we could submit this to you in writing later.

COMMISSIONER LEMAN: I do not think we want to make a big issue of it, Mr. Milner. I just wanted to point out that that looked to be a strange situation.

MR. BEATTY: I think he is referring to the source capital rather than the percentage earnings that are retained. The retained earnings are a greater proportion of the sources of capital available to these smaller companies.

COMMISSIONER LEMAN: Well, as I say, it is not a major issue.

I would like to go through these questions rather

fast because time is getting on.

There is a reference in Section E, paragraph 36 to the effect that private placements are becoming more prevelant as time goes by. I suppose there is statistical evidence to support this, but it does not appear in the brief as far as I can tell. Would you guess why that is?

MR. MILNER: The private placement method of financing is cheaper in most instances than public financing. In its instigation in Canada, and I am speaking of in Canada particularly, some of our larger insurance companies who, with their contacts with various industrial concerns both large and small -- whether they approached the company or the company approached them, I do not know -- have made the suggestion through a dealer in all instances that if the dealer would put these things togehter, they would be prepared to advance the company the money that was required under certain circumstances, and the dealer has drawn up the trust deed, etc., and has been paid a fee for such type of financing.

Mr. MacKeen brought this up in his remarks before, that in bond financing of that kind it can be quite costly over a period of years to the corporation. It would not be at current interest rates, I hope, but at other interest rates when it is lower, it does become more expensive than previously. Your question I assume was asked in respect of the cost of such underwritings, and it is cheaper.

COMMISSIONER LEMAN: That was not quite my

last question. Why do you think it has become more prevelant? Do you think it is because in general the cost to the borrower is somewhat lower?

MR. MILNER: Yes.

COMMISSIONER LEMAN: Assuming that that is so, the question stems from that: Do you think there would be a good case to be made for a wholesale price for corporate issues and a retail price, the two being different?

MR. MILNER: Mr. Leman, our industry is convinced that the proper method of selling securities is at the same price for all investors. We have found it has worked out far better to have one price only rather than a wholesale and retail price. That applies through the whole series of our operations both in government bonds, provincial bonds and corporate bonds.

COMMISSIONER LEMAN: Therefore there is nothing today against private placements if they are going to take place?

MR. MILNER: No.

COMMISSIONER LEMAN: Yet in paragraph 38 B you point to the reduced interest to insurance companies for corporate bonds. Would you say that a reduced interest only on those bonds that are publicly offered is a good thing, because you just said there was a trend toward private placements?

MR. MILNER: Did you refer to paragraph 38 B, sir, in Section E?

COMMISSIONER LEMAN: It appears at page 13 in Section E; you say that the reduction in the leading role

of the insurance industry requires the investment dealer to turn to several other sources. The implication there is that there has been somewhat less interest on the part of the insurance companies for corporate bonds.

MR. WADDS: I would think that is a matter of opinion, personally.

MR. MILNER: The answer to that, Mr. Leman, is that in the last few years there has been quite a marked change in the private placements mortgage type of investment by our leading insurance and other pension fund type of obligation, where they have financed by means of direct mortgage rather than through the bond route. This has cut down the amount of the public financing particularly in the secondary corporations, such as shopping centres and that type of instrument. The shopping centres have been financed largely by means of direct mortgages with insurance companies.

COMMISSIONER LEMAN: Those are lease-backs?

MR. MILNER: And are lease-backs.

COMMISSIONER LEMAN: As I say, I am going through these rather quickly. I would just like some simple answers.

In relation to paragraph 50 of Section E you make the recommendation that the legislation be amended so as to permit comanies to deduct in arriving at taxable income the actual cost of underwriting. Who do you think that would benefit most, the operators or the investment industry?

MR. MILNER: Mr. Shaw, would you like to answer that?

MR. SHAW: Briefly, the borrowers.

MR. COX: However, it might make refundings more frequent.

COMMISSIONER LEMAN: Well, if we might jump now to 59 on page 21. You make reference there to the fact that there are some things in the Canadian Companies Act which tend to deter incorporation of companies under its positions, and so on. What are the features that draw people away from federal incorporation?

MR. MILNER: There has been, I believe, for about three years now -- there have been several committees formed from the leading corporate legal firms endeavouring to persuade the government to amend the Companies Act to cover a lot of the situations that are -- that they believe they could probably deal with better than they are dealt with under the present Act.

Take as an example the merger of a federal company with a provincial company where you run into the surplus situation. We put this into the brief wanting to see if it was possible to have the Companies Act looked into seriously for revision, but we do not want to go into it in detail because we believe that this is under corporate law and that is the place where it should be dealt with. We did not deliberately -- we do not want to go into the details because it is a thing that is beyond our ken.

COMMISSIONER LEMAN: You are not implying it has a great effect on the matters we are discussing here, the flow of opinions, and all that sort of thing?

MR. MILNER: Yes, it has an effect on the flow of opinions. We think that a proper interpretation of the Companies Act would assist in the financing of industry.

MR. SHAW: And in particular where it lists some of the things in the latter part of that paragraph which we think should be revised.

COMMISSIONER LEMAN: Would you turn now also quickly to paragraph J.9. You are referring there to secondary distribution. The argument here is to the effect that in the Canadian market the commissions paid in this operation are double the minimum stock exchange commission, whereas in the States it ranges from four to 6½ times the average minimum commission rate. What is the base, what is the minimum commission rate in both places?

MR. CRETZIANU: These are secondary distributions for which there are no set fixed commissions, and the broker is at liberty to ask for whatever commission he thinks the market will pay.

In the United States several of the secondary distributions, the majority of the secondary distributions, have been done at substantially larger spreads than in Canada. There have been many examples of an overwhelming number of secondary distributions at over four times the usual commission while in Canada the secondary distributions are generally done

at the double commission.

COMMISSIONER LEMAN: But is the usual commission lower than down there?

MR. CRETZIANU: No, the stock exchange commission in the States does not differ very much from the Canadian one. It might be a little lower on certain kinds of stocks.

COMMISSIONER LEMAN: Well, elsewhere there is a paragraph which tends to try to prove that underwriting in Canada is not much more costly than in the States, and here on the secondary distribution it is your assertion it is less costly on the average in Canada than in --

MR. CRETZIANU: Yes, it is a fact which can be proved, that the commissions on secondary distribution in the United States are substantially higher than in Canada.

COMMISSIONER LEMAN: I would like to ask you one more question. Going back for just a second to the municipal financing, do you believe that a municipal bond rating service in Canada would be of great use to the industry and to the municipalities, especially less known ones; if they knew that they could make arrangements with a service to get themselves rated?

MR. MILNER: Mr. Beatty, would you care to speak to that?

MR. BEATTY: I believe it would be a useful service.

COMMISSIONER LEMAN: Well, somebody has to pay

for the service. Do you believe it is viable?

MR. BEATTY: If it were such that it would be obviously profitable, I believe there are several organizations who would have undertaken it by now.

COMMISSIONER LEMAN: You do not believe it would be viable?

MR. BEATTY: No, I do not believe it would be profitable.

COMMISSIONER LEMAN: I would like now to turn quickly to two sections on which I do not have very many questions to ask, and one is the risk capital section that you discuss in I, and then small business financing in L. There is a relationship there between the two. It shows what is being done by the present sector and we have heard from other people that it would be a good thing if the I.D.B. were disassociated from the Bank of Canada. Does the Association have an opinion on this score?

MR. MILNER: By being completely disassociated from the Bank of Canada, you mean it is run as a separate government department?

COMMISSIONER LEMAN: Yes, it would be removed from the control and influence of the Bank of Canada.

COMMISSIONER MACKINTOSH: Presumably a separate Crown corporation?

COMMISSIONER LEMAN: This has been suggested to us as a desirable development, and I just asked --

MR. MILNER: We have never frankly thought

of it, Mr. Leman. Just as a quick answer I could not see where there would be any difference. Surely it would be under the same aegis of government control, and I would not think that it would change the policy very much. I think what some people have complained about was that the I.D.B. was infringing on private enterprise in certain of their loaning policies; that is, under the incorporation of the I.D.B. it was supposed to be as I understand, a bank of last resort where people who could not borrow elsewhere were given government aid, and the difficulty with I.D.B. as I see it -- the same difficulty, of course, exists in the finance companies to some extent -- that a lot of people that are borrowing from those two sources, that what they really need is capital and not borrowed money. It is not loans they want, it is some capital, and I think that this new corporation that has been formed generally by one of our members here, plus a lot of the larger institutions, is along the lines that we believe can be of great benefit to the country for the period of years where they are supplying capital, straight capital, to enterprises, which is what the enterprises need, rather than borrowed money, and if the bank were divorced from the Bank of Canada, -- the I.D.B. -- I do not see that it would necessarily change this policy.

COMMISSIONER LEMAN: These other people must have thought it might because this is the suggestion that they made.

At the end of both sections -- and I have

mentioned I and L -- you end up with a recommendation in each case that some change be made in the tax structure to provide an incentive for raising capital investment, and more specifically in the small businesses. Well, that is something one often resorts to, but do you believe in general that we ought to start plugging our tax structure? After all, there is a little problem that crops up in the economy where they pay some kind of a tax incentive.

MR. MILNER: No, I think that would be the worst thing one could do.

MR. BEATTY: In this type of high risk operation that is envisaged, the provision of a reserve is the type of tax incentive that might make it worthwhile.

MR. SHAW: This is the sort of thing that has been used in European economies to encourage new risk capital; the sort of thing that has been done, I believe, in West Germany where they exempt from taxation, from your taxable income, the amount of money that you put into a new venture. That is generally the approach, without going into the details of the thing. This is the incentive to the man with the capital to put his money into a risk venture and he shares the burden with the government, but it seems to work.

MR. MILNER: Could I ask Mr. Leman to speak on that as well?

MR. LEMAN: I would like to say a few things concerning the Industrial Development Bank. It has been the feeling of this Association that the bank

should not operate in economic spheres where underwritings by our Association are available at reasonable cost. In practice this has been found to be in direct competition with the Industrial Development Bank but only on rare occasions do we recognize it.

The other aspect of the operation lies in the most beneficial way in which it might operate in favour of small businesses; we do not pretend that this organization should be self liquidating, but we feel it should be a non-profit making organization and that if in support of sound management the security required for each loan is high, it could all be realized on repayment of the loan and not retained to create reserves as security against future risks. The feeling of the I.D.B. is that it is very onerous on the small operator, and besides giving three or four or five year term loans they want additional security in the form of bonus shares or common shares and to retain these shares once the loan has been repaid, which accounts substantially for the important amount of surplus accumulated in the investment development.

COMMISSIONER LEMAN: On that section, the I.D.B. is run as a completely non-profit organization but circumstances flow from that. First of all, it would definitely be more competitive with the private sector than if it operates at a profit?

MR. LEMAN: Well, the answer to that is the fact that in principle there are members who welcome any and all enquiries for underwriting purposes.

There are no corporate ventures which are not included in the services of our members. Some difficulties arise in the size of the borrowings desired and the quality of the management may be of the essence, but in principle we welcome any and all borrowers who request the services of our members.

COMMISSIONER LEMAN: I think this is all I have.

COMMISSIONER MACKINTOSH: Could I go back to your earlier answer, Mr. Leman. I understood you to say in cases where the borrower had paid back his loan that the I.D.B. ought to return the bonus shares they had taken.

MR. LEMAN: Well, the I.D.B. does not necessarily retain them, but they sell those shares back to the owners of the business.

COMMISSIONER MACKINTOSH: Oh.

MR. LEMAN: And it turns out to be a very onerous operation on the part of the borrower.

COMMISSIONER MACKINTOSH: Does he have to buy them?

MR. LEMAN: Well, his capital structure is left in the hands of the I.D.B.; it is a measure of security. It is sound management from the point of the I.D.B. to enable it to take over a venture if it is not running properly, but if the operation has been successful and the loan has been repaid, well the I.D.B. could move out of the picture without penalizing the owners of the business to that extent.

COMMISSIONER MACKINTOSH: What about the

incidenc where they took bonus shares and the venture did not succeed?

MR. LEMAN: Well, the I.D.B. loans only on -- they have the security there. Some of their loans have turned sour, but the experiences has shown that there has been $18 million surplus accumulated over the period of years that the bank has been operating and the outstanding loans totalled $75 million at the end of last year, which shows a pretty sound reserve for future risks they might take.

COMMISSIONER LEMAN: I have one last question in a completely different field. We have heard a lot through the brief and through the discussion about call loans. Are such loans called? Is there a record of their being called often?

MR. SHAW: We refer to them as "so-called loans"!

COMMISSIONER LEMAN: They are not called?

MR. JOHNSON: There are occasions when they are called, but very rarely.

MR. LEMAN: But very rarely.

COMMISSIONER LEMAN: Would there be a case for a monetary policy if they should be called more frequently in response to monetary conditions?

MR. SHAW: I find difficulty in seeing the purpose of that other than to embarrass the members of our industry who might be enjoying the loan. What purpose would there be in recalling -- these are the lateral loans which we use from day to day in our business and apart from the ones that apply to many markets;

is it your suggestion that the monetary policy would be to restrict the operations of the dealers by suggesting to the banks that they reduce the amount of loans outstanding to the dealers?

COMMISSIONER LEMAN: Is not the point that you want to make here that you have to at certain times finance with the country banks?

MR. SHAW: That is a matter of economics.

COMMISSIONER LEMAN: But presumably the rates are different, are they not?

MR. SHAW: Quite substantially.

COMMISSIONER LEMAN: Therefore, would it not be a further instrumentation of the monetary policy if they were called in?

MR. SHAW: And force out into the country banks the few that are left with the chartered banks?

COMMISSIONER LEMAN: Yes.

MR. SHAW: Or absolve it.

MR. ELY: You mean that the monetary policy might use that device to shrink the overall loan position by having the loan called and the security that was lodged against that loan sold?

COMMISSIONER LEMAN: Perhaps in the same way that happens to the bank.

MR. SHAW: I think that we would consider that an undesirable development!

COMMISSIONER GIBSON: This is in connection with the effect of interest rates and credit conditions on the investment dealers; in other words, how does the monetary policy work through the investment organization.

To be a little more specific, in tight money, in 1956 and 1957 and again in 1959, what happened to the supply of funds for the new issues? Did they tend to dry up?

MR. MILNER: The availability for new issues?

COMMISSIONER GIBSON: Yes, indeed.

MR. MILNER: Yes, during some of that period there was definitely a rationing of issues. In other words the interest rate took care -- not rationing, but the interest rates ---

COMMISSIONER GIBSON: The interest rates did the rationing?

MR. MILNER: That is right.

COMMISSIONER GIBSON: And this was effective; in other words, it cut the demand down to fit the reduced supply?

MR. MILNER: Yes; take, for instance, in the municipal field: There was a number of instances in the municipal field where the improvements a municipality wanted to put in had to be postponed for a year on account of the interest rate.

MR. SHAW: Specifically, I believe cases could be found where pending underwritings at that time were deferred because the underwriter involved did not have the assurance that he needed that loan accommodation would be available to him at his bank.

COMMISSIONER GIBSON: For him to underwrite the loan?

MR. SHAW: If I understand your question correctly, does this tight money condition -- under the loan ceiling

the only course left to the bank is that of rationing the available resources they have, and in such a period the underwriter would be very prudent if he were to have discussions with his bank to find out if he fitted into their rationing programme at the time.

COMMISSIONER GIBSON: In other words, credit rationing by the bank meant less funds were available through the new issue market?

MR. SHAW: Itcould have been. It didn't turn out to be serious because in that particular period the climate was not good for an underwriting, in any event.

COMMISSIONER GIBSON: Well, how much did the supply of new funds fall off in these two periods? Was it a sharp reduction?

MR. SHAW: No.

MR. BEATTY: It was a sharp reduction in the corporate field.

MR. SHAW: Not for the reason the underwriter could not secure the accommodation, although it was a factor in the odd case, but it was simply that the whole investment climate was such that the underwriter would not mount an issue until the conditions clarified.

COMMISSIONER GIBSON: Looking at it the other way round, did the high interest rates cause many postponements and deferments, and so on? Would you give a few examples of this sort of thing?

MR. SHAW: We made some effort to find cases where that happened and found some difficulty in finding specific instances where a borrower was steered away

from the market because of the cost of his money. It was more a concern about the success of his issue almost under any reasonable interest rate terms.

COMMISSIONER MACKINTOSH: Of course, isn't that the same thing? If the borrower says, "I would be willing to pay more. I would be willing to pay anything reasonable", but the underwriter says, "To really make this issue a success you have got to pay a little more than is reasonable"?

MR. SHAW: I think what would more likely happen is that the underwriter would advise his client against coming to the market under those conditions. He would not wish to see the credit of that particular corporation, which had enjoyed a relatively high rating, being forced into another category, if you like, or on to another shelf because of conditions which, according to every expectation, would prove to be ---

COMMISSIONER MACKINTOSH: Whatever level you take the decision off at, it is all the same compound of reasons?

MR. MILNER: In other words, the effect was decreased borrowing.

MR. SHAW: Deferment.

COMMISSIONER GIBSON: Where did you notice this deferment most? You have been speaking of the corporate field and the municipal field.

MR. SHAW : I would think it became most apparent in the municipal field at that time with the deferment on the part of individual municipalities coming to the market under those conditions, deferring

their financing until a later date, but I would certainly like to hear other expressions on that.

MR. BEATTY: I would agree. The lower quality corporate borrower too deferred projects.

COMMISSIONER GIBSON: Did most of these projects actually get deferred? In other words, did people succeed in stirring up money from somewhere else, to your knowledge, or were the projects actually deferred?

MR. SHAW: There was a number of factors involved including the effect on the judgment of the board of directors of the company. In such times their attitude towards expansion is certainly affected if the whole situation is not particularly promising. The psychological effect upon the people who are planning expansion is particularly noticeable in such difficult times.

COMMISSIONER GIBSON: You think these tight money periods have really caused quite a deferment of expansion in the corporate as well as the municipal field, do you?

MR. SHAW: I can't give you specific evidence that that was so in so far as giving you illustrations of cases where it happened, but I would express the general view that in total there probably was a considerable amount of deferment developed in 1959.

COMMISSIONER GIBSON: And 1956, 1957.

MR. SHAW: That period.

COMMISSIONER GIBSON: In the corporate fields did you see much evidence of people going to other sources, particularly to the United States, to get the

money?

MR. SHAW: No.

MR. ELY: Not necessarily, because most of the Canadian corporations have earnings in Canadian dollars and would be unwilling to commit themselves to paying American funds for their money.

COMMISSIONER GIBSON: Some of them, of course, have corporate relationships with the United States?

MR. ELY: Yes, they would sometimes look to that market but only if they had an income in the countries where they were borrowing other than Canada.

COMMISSIONER GIBSON: What about your portfolio management advice during change of money conditions? In tight money, for example, is the sort of advice you give to your clients a very radical change to reflect the monetary conditions?

MR. CRETZIANU: I would think that in periods like today, when you can get very good returns on short-term money, we would advise our clients to keep their liquidites more in the short-term of the market. Generally, you are penalizing a portfolio by adopting a very liquid position. Either you keep the cash, which gives you very little return, or short-term securities which again gives you a low return when compared to the long-term bonds. But at times such as now, for instance, you can have the best of both worlds and have both liquidity and a very good return.

COMMISSIONER GIBSON: And this, of course, is a pretty marked change from the kind of advice people would be given a year and a half ago?

MR. CRETZIANU: Certainly.

COMMISSIONER GIBSON: When money was easier a year and a half ago, would there be a big switch in advising people to go into stocks, and so on?

MR. CRETZIANU: It all depends on the nature of the portfolio. We adopt for certain portfolios much more defensive positions than for others. Take the position, say, of an old person who has no other income than his small pension and his portfolio: We would advise a very defensive position, and whether money was tight or easy we would certainly advise keeping at least 30 or 40 per cent in long-term bonds in order to have both a good return and a very defensive position. On the other hand , a person with a good income of his own, with adequate protection when he retires, certainly would be advised to keep the bulk in equities in order to try to build a capital position situation.

COMMISSIONER GIBSON: But is there quite a change in the direction of investment -- let us say, the change from 1956, 1957 when money was fairly tight to 1958, 1959 or 1959, 1960 when it was fairly easy?

MR. CRETZIANU: As far as portfolio management is concerned I still think it is at the short end of the market that it would influence our decisions. The factors which have brought tight money may induce us to advise clients to switch their stocks because the companies involved may be more vulnerable in periods of stringent credit conditions.

COMMISSIONER GIBSON: Stringent credit conditions are sometimes a reflection of the fear of inflation.

MR. CRETZIANU: Yes.

THE CHAIRMAN: There is just one question I had in mind. Earlier in the proceedings there was reference made to the activities of your members in primary distribution of equities, and I gathered the impression that you did quite an extensive business in primary distribution of equities, or what might be called risk capital. You have a few paragraphs on risk capital in the brief, and I don't think we have anything in the brief, and we haven't heard yet any indication of the magnitude of this sort of activity or the nature of it, and I think for the record it might be well to have some information of that kind.

MR. ELY: The magnitude of equity financing in Canada?

THE CHAIRMAN: Through members of your organization.

MR. ELY: I think members of the Investment Dealers' Association probably do a very large volume of equity financing. When you think in terms of the amount of money through equities that have been raised for the chartered banks, the utility companies such as Bell Telephone, the steel companies, the gas pipeline companies, and the oil transportation companies, and many, many others, I would think from our records it is a very large volume.

THE CHAIRMAN: Would there be any advantage of having some more particular information of the issues of that kind that have been made over the last few years?

MR.BEATTY: It would be in the Bank of Canada statistical summaries.

THE CHAIRMAN: Well, if we could have a reference to that, that perhaps would be good enough.

MR. ELY: I think there are references to that, Mr. Porter. I think you will find the volume is very large.

MR. SHAW: It has been on a descending scale in the last 10 years.

THE CHAIRMAN: During our hearings throughout the country it has been pointed out from time to time there are certain difficulties in raising equity capital. It always seemed to me there was a great deal of equity capital raised in this country from year to year, but I would like to have it on the record of this Commission.

MR. SHAW: Something that might be added to the record, Mr. Chairman, is that under the conditions that prevailed in the last two years through the energies ofour association there has been repatriated to Canada very substantial amounts of Canadian stocks which were previously held by what we refer to as the N.R.O. investment companies -- Non-Resident Owned investment companies -- which were put together in great size over a four or five year period from about 1954 to 1957 or 1958, which in the past two years, for one reason or another, have been divesting themselves of these shares and they have been returned to Canada and placed in the hands of Canadian investors very largely through the activities of members of our association. I think that is an accurate statement.

MR. ELY: I think that is quite correct. There has been a tremendous amount of repatriation, of foreigners selling our Canadian equities and their being absorbed into Canadian hands -- a very large volume -- for the last two years all running in one direction: Foreigners selling and Canadians absorbing.

COMMISSIONER MACKINTOSH: Could you give a rough idea in the equity capital raised of what the proportion was to subscription rights and what by direct underwriting?

MR. SHAW: The great weight of new capital, the significant new equity capital raised in Canada in the past four or five years would be through rights by reason of the fact this capital was raised by larger and more significant corporations expanding their equity base.

MR. BEATTY: This is primary stock equity capital. Preferred, of course, have gone the other way.

MR. MILNER: Would you care to have us submit some figures to the Commission, Dr. Mackintosh, as to the total amouut involved?

COMMISSIONER MACKINTOSH: I don't know that is necessary.

THE CHAIRMAN: Personally, I would like to see figures on the whole situation, not only on the breakdown as to the rights aspect of it, but generally speaking. I think it would be useful to have that on the record.

MR. SHAW: Might I suggest, Mr. Chairman, through your secretariat; any figures that have been suggested here that they have not already put together, or do not have readily available, that we might assist in the gathering of that, and we would more than willing to co-operate.

THE CHAIRMAN: Well, you see what we have in mind, and see to what extent new enterprises have been financed and equity financing, and existing enterprises have expanded: It will be very interesting to have that information.

MR. MILNER: We will get the information for you, Mr. Chairman.

THE CHAIRMAN: In due course.

MR. MILNER: Yes, in due course.

THE CHAIRMAN: Gentlemen, thank you very much for the vast amount of information you have contributed to us in the last two days. It has been a very useful discussion from our point of view and I hope it has been from yours, and we appreciate very much indeed the tremendous amount of work and the tremendous amount of thought which you have put into the very comprehensive brief.

MR. MILNER: Could I express, Mr. Chairman, on behalf of everyone here our appreciation of the very wonderful treatment we had at the hearings. We have enjoyed every minute of the discussions. I know I am speaking for everyone here.

THE CHAIRMAN: I think that enjoyment is from hindsight. We will now adjourn until 8.45 A.M. tomorrow.

--- Adjournment.

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Royal Commission on Banking and Finance

Investment Dealers' Association of Canada.

Hearings
held at
Ottawa

Vol.	Date.
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VOLUME I

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FOREWORD

In planning the preparation of this Brief, The Investment Dealers' Association of Canada gave consideration to the size and scope of the subjects to be considered. The Association concluded that it would either have to obtain the services of professional consultants or that it would have to break up its presentation into a number of subjects and have one or more of its Members prepare memoranda on an assignment basis. It was appreciated that the latter method would produce considerable variety in style and approach, but these drawbacks were thought to be more than compensated for by the intimate knowledge on which our Members could draw in dealing with the subjects at hand. The memoranda supporting this Brief were, therefore, prepared on a "committee" basis.

The Association regrets that certain statistical and financial information which the Commission would like to have and, which it would like to offer, is not obtainable. Neither the individual firms nor the industry as a whole, have maintained records of the type which would enable detailed answers to some of the questions asked by the Commission on internal operations. In some cases, this information is not obtainable because of the overlapping nature of the stock, bond, money market and underwriting business. However, the trend toward centralized record-keeping, through the use of computers, may provide the inform-

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ation for more detailed analysis in the future.

A.J. Milner

President

The Investment Dealers' Association
of Canada.

June, 1962

RECOMMENDATIONS AND SUGGESTIONS

The following recommendations and suggestions are derived from and supported by the evidence and exhibits comprising Appendices A - N. These recommendations and suggestions appear in more detailed form at the end of the various appendices. A minority of members have indicated that they do not concur with those marked with an asterisk (*).

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA RECOMMENDS OR SUGGESTS:-

with respect to

I. GOVERNMENT OF CANADA ECONOMIC AND FISCAL POLICY:

	REFERENCES	
	Appendix	Paragraph
1. that a sound fiscal policy be adopted immediately by the Government of Canada; that inherent in this policy be the objective of approximately equivalating budgetary deficits which may be incurred in recession years with surpluses in years of prosperity and that this policy be considered essential to the effective operation of the Bank of Canada and the maintenance and growth of a broad market for capital in Canada;	B	22,32-40
	C	62,74
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	F	32-39

A.4

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	REFERENCES	
	Appendix	Paragraph
2. that the Commission examine the areas of conflict between debt management and control of currency with a view to determining whether these functions should be separated;	B	14-16
	C	8 -13
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3. that the Commission examine the Bank of Canada's role in operating the purchase fund and its trading for Government accounts with a view to determining whether these functions should be handled by the Department of Finance or other trading agencies;	B	14-16
	F	50
4. that the Commission examine the Government's exchange policy with a view to determining the adequacy of our exchange reserves, our position vis-a-vis the International Monetary Fund and the desirability of a "pegged" rate;	C	36,37
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5. that the Commission consider the valuable contribution of foreign capital to Canada's post-war development and recommend policies intended to maintain a favourable investment climate in Canada to ensure that this capital be available, if and when needed;	J	59
6. that, to the extent that it is necessary or desirable to import capital	M	35-44
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6. that, to the extent that it is

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from foreign countries, Government of Canada policies be established which will encourage the purchase by foreigners of debt securities rather than equity investments of all kinds;		
7. that the Commission examine the question of withholding tax on all foreign flows of short term investments into Canada's money market with a view to recommending that they be not discriminated against because they have little influence on the factors affecting non-resident control of Canadian resources and manufacturing;	G	57
8. that the federal budget address be delivered during the month of April each year;	F	31
9. that an informative public statement on the state of the nation be made by the Federal Government annually during the month of October;	F	31
10. that a standing committee composed of men from The Investment Dealers' Association of Canada having experience and independent judgment in the marketing of Government of Canada Bonds be established by	B C Exhibit 7 I	61-65 9-13 21-28 35 13-19 46

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8. that the federal budget address be delivered during the month of April each year; F 31

9. that an informative public statement on the state of the nation be made by the Federal Government annually during the month of October;

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Government decree to act in an advisory capacity to the Bank of Canada and the Department of Finance in connection with such matters as the marketing of Government of Canada issues and open market and trading operations;		
11. that an annual sinking fund of 1 per cent of the principal amount of Government of Canada issues with maturities in excess of three years be established;	B	13
12. that the Commission examine the advisability of placing less emphasis on Government financing through Canada Savings Bonds and inquire into the proper maximum limit of purchases of these Bonds consistent with maintaining them as a true savings instrument;	B C	26-32 9(v)
13. that the Government at the time of issue offer at least a substantial portion of all new issues to the public through normal channels at advertised prices;	B C F	63-64 10 48
* 14. that the financing of the Canadian National Railways and other Government agencies be arranged through large national syndicates composed of investment dealers;	B C Exhibit 7	66 13
15. that, with the exception of 13	B	42-59

Government decree to act in an advisory capacity to the Bank of Canada and the Department of Finance in connection with such matters as the marketing of Government of Canada issues and open market and trading operations;

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12. that the Commission examine the advisability of placing less emphasis on [illegible] Savings Bonds and inquire into the proper maximum limit of purchases of these Bonds consistent with maintaining them as a true savings instrument; B 26-32, C 9(v)

13. that the Government at the time of issue offer at least a substantial portion of all new issues to the public through normal channels at advertised prices; B, C, F

* 14. that the financing of the Canadian National Railways and other Government [illegible] national syndicates composed of invest- B

[illegible]

	REFERENCES	
	Appendix	Paragraph
and 14 above, the present economic and efficient methods employed in Canada for treasury bill financing, marketing of Government of Canada and provincial issues be continued;		67-76

with respect to

II TAXATION:

16. that a Select Committee be formed to study and assess the entire tax structure of Canada with the objective of devising an improved taxation system better able to meet Canada's economic needs; that before holding public hearings such Select Committee carry out its initial deliberations on a confidential basis at the highest level in order to arrive at some definite conclusions under objective conditions; that such Sslect Committee be composed of highly qualified individuals having a broad working knowledge of the present tax structure with most emphasis being placed on its practical operation in business and in the economy as opposed to its legal and accounting operation and that such a Committee be composed primarily of representatives of business from members of The Canadian Chamber of Commerce and Board of Trade,	N	35(2)(i) (ii) + (iii)

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	Appendix	Paragraph
representatives of finance from members of The Investment Dealers' Association of Canada and The Canadian Bankers' Association, practical economists, representatives of the Canadian Tax Foundation, and, secondarily of members of the legal and accounting professions;		
17. that the Commission consider recommending that the twelve specific areas of our tax structure outlined in Appendix N be carefully studied, with particular reference to:	N	14-33
(a) an incentive method of applying taxation;	N	23
(b) the use of indirect taxation as an alternative or partial alternative to personal and corporation income tax;	F N	38 (2) 19-22
(c) the tax disadvantage to Canadians, compared to U.S. citizens and corporations, in respect to the development of Canadian oil and gas natural resources;	J N	66 31
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(e) the requirement of the Canadian economy for continuing and	N	29

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substantial growth in which an ever increasing quantity of equity capital is essential and which indicates that any capital gains tax would be inadvisable and not in the best interests of Canada; and		
(f) the merits of enabling a taxpayer to obtain a tax ruling prior to a transaction;	N	30
18. that corporate income tax legislation be amended to permit companies to deduct financing costs as expenses;	E	50

with respect to

III. BANK OF CANADA:

	Appendix	Paragraph
19. that the Bank of Canada Act be amended generally to clarify the Bank's relationship with the Government and particularly to establish an improved procedure for the resignation of the Governor of the Bank of Canada either by his own volition or by request of the Government or parliament;	C Exhibit	7 4
20. that the Commission examine the use of "moral suasion" by the Bank of Canada to influence such things as stock margins, instalment	C Exhibits	44-60 31-42

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an ever increasing quantity of
equity capital is essential and
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Bank of Canada to influence such

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sales, term lending by chartered banks and the reserves of "near banks";		
21. that the Board of Directors of Bank of Canada be selected from men experienced in matters of finance and business;	C Exhibit 12	18,19
22. that direct participation of the Board of Directors of the Bank of Canada in policy making be established by having the executive committee of the Board meet fortnightly and the Board as a whole meet monthly;	C	19
23. that, in order to convey to the nation the economic health of the country, an administered bank rate be re-established;	C Exhibits 29-30 F	41-42 40
24. that, in order to continue to foster the growth of the money market, the right of participants to sale and repurchase agreements with the Bank of Canada to the extent of their lines of credit and at the average weekly tender for 90 day bills plus $\frac{1}{4}$ of 1 per cent be continued; (for minority view see Appendix C-43)	B G	19-21 45-48
25. that closer liaison be	G	48

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of "near banks";

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continued; (for minority view see		

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established between the Bank of Canada and the money-market dealers for the purpose of trading in money-market securities;		
*26. that the Commission consider recommending that the agreement between the chartered banks and the Bank of Canada in 1956 establishing secondary reserves be terminated;	C Exhibits 26,27	40,60
27. that the Bank of Canada be urged to publish from time to time pamphlets intended to clarify the Bank's functions and actions;	C Exhibit 11 F	17 53
* 28. that the trading departments of the Bank of Canada in Toronto and Montreal be given more authority;	C Exhibit 20	29-30
29. that the Bank of Canada be urged to institute a programme designed to expedite its replies to firm bids or requests for firm offerings from dealers;	F	46

with respect to

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the work presently in progress to achieve this objective;		
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32. that the various securities acts be amended to permit the distribution of preliminary prospectuses to prospective securities purchasers;	E	55
with respect to:		
V. <u>JUNIOR GOVERNMENTS</u>:		
33. that the Commission consider recommending the use of savings loan type issues by provincial governments be sharply curtailed;	B	33-40
34. that life insurance companies be permitted to evaluate holdings of municipal securities at the amortized book value in the same manner as for federal and provincial securities;	D	22
35. that school debentures, owned by non-resident insurance companies, be accepted for deposit by the Federal	D	23

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book value in the same manner as for
federal and provincial securities;

35. that school debentures, owned D 23
by non-resident insurance companies, be

	REFERENCES Appendix	Paragraph
Department of Insurance;		
36. that no change be considered with respect to the tax status of interest payments on municipal debentures.	D Exhibit E	24
with respect to		
VI. CHARTERED BANKS:		
37. that every encouragement be given to the continued healthy development of the investment dealer's ability to perform satisfactorily the important underwriting function, and, in particular,		
(a) that the banks continue to refrain from making term loans in excess of a reasonable limit in amount to business corporations where the time of repayment is deferred beyond that of ordinary bank loans and from purchasing a security negotiated directly with the customer as distinct from buying a publicly issued security in the market and	H	28 41-42
(b) that there be no further extension beyond the relatively few cases of long standing which may exist, of the inclusion of banks in syndicates underwriting corporate securities for resale to the public, particularly where	H	44-49

Department of Insurance;

36. that no change be considered — D — 24

with respect to the tax status of — Exhibit E

interest payments on municipal

[illegible]

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(b) that there be no further extension beyond the relatively few cases of long standing which may exist, of the inclusion of banks in syndicates underwriting corporate securities for — H — 44-49

	Appendix	Paragraph
such inclusion would place the bank in the dual position of banker and underwriter and where the sale of corporate securities is for the purpose of paying off bank loans;		
38. that section 91 of the Bank Act and section 71 (1) of the Quebec Savings Bank Act, which sections impose a ceiling of 6 per cent on rates that may be charged on bank loans, be repealed;	H	14-17
39. that the chartered banks be encouraged to adopt policies and procedures resulting in their call loan interest rate schedules being subject to periodic review and to take appropriate action to keep these rates in line with market conditions and competitive rates from other sources;	H	3-13
with respect to		
VII. <u>FINANCING SMALL BUSINESS:</u>		
40. that the Commission consider recommending that special tax advantages be given to investment companies specializing in financing small businesses;	L	13
41. that the Commission consider recommending that the proceeds from loans to small businesses by institutional	L	2, 5, 9 10

such inclusion would place the bank in the dual position of banker and underwriter and where the sale of corporate securities is for the purpose of paying off bank loans;

38. that section 91 of the Bank Act and section 71 (1) of the [illegible] sections impose a ceiling of 6 per cent on rates that may be charged on bank loans, be repealed; H 14-17

39. that the chartered banks be encouraged to adopt policies and procedures resulting in their call loan interest rate schedules being subject to periodic review and to take appropriate action to keep these rates in line with market conditions and [illegible] with respect to

VII. FINANCING SMALL BUSINESS:

40. that the [illegible] [illegible] be given to investment companies specializing in financing small businesses;

41. that the Commission consider recommending that the proceeds from L 2, 5, 9, 10

	REFERENCES Appendix	REFERENCES Paragraph
investors be subjected to a reduced corporate tax burden in order to encourage this type of financial activity;		
42. that the banks and insurance companies be encouraged to apply a portion of their funds to the financing of small businesses through equity purchases or long-term loans to small business investment companies similar to those operating under the Small Business Administration Act of the United States;	L	3,5,8,9
with respect to		
VIII. MISCELLANEOUS		
43. that the difficulty of obtaining accurate statistics for assessing the roles of the various borrowers in the money market be recognized and that more information be obtained and published concerning the borrowing by provinces, municipalities and corporations in the money market;	G	16,24 29,36 49
44. that the inadequacy of the statistical material available concerning stocks and stock ownership be recognized and that the Dominion Bureau of Statistics assemble and	J	20,27 31

	Appendix	Paragraph
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reduced corporate tax burden in		
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[illegible]		
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cerning stocks and stock ownership		
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publish this material;		
45. that the Commission examine the participation in the stock market of Canadian financial institutions and pension funds in comparison with those in the U.S. and make such recommendations as will encourage increased participation by them;	J Table	65 15
46. that the Commission examine the important matter of expropriation of electric utilities with a view to recommending that the Federal Government devise means to minimize the temptation to expropriate arising out of Federal tax treatment of the provinces;	E	57
47. that the Commission examine shareholders rights in the light of certain recently employed "take-over" techniques;	E	58
48. that the Commission examine the Companies Act of Canada with a view to recommending removal of certain anomalies in it which tend to deter the incorporation of companies under its provisions.	E	59

That in its deliberations on this

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47. that the Commission examine shareholders rights in the light of certain recently employed "take-over" techniques; — E — 58

48. that the Commission examine the Companies Act of Canada with a view to recommending removal of certain anomalies in it which tend to deter the incorporation of companies under its provisions. — E

and other submissions the Commission be aware that the Investment Dealers' Association of Canada believe it to be in the best interest of Canada, that, insofar as is possible the changes which the Commission deems it advisable to recommend be induced by the provision of suitable incentives rather than through legislative action.

S U M M A R Y

(The following is a summary of Appendices A to N which contain the detailed evidence supporting this Brief).

THE INDUSTRY AND THE ASSOCIATION

The Industry - Appendix A (part 1)

1. The investment business as we know it today dates back to the 1880's. At the outbreak of the 1st World War, over three-quarters of all new issues of Canadian bonds were still being placed in London. It soon became necessary for Canada to turn to domestic sources to finance the war effort. In six loans the investment community was able to raise over $2.2 billion from 2.8 million subscribers. The magnitude and success of this effort stimulated the rapid development of the industry in Canada.

2. In 1920 a committee of dealers and banks was formed at the request of the Minister of Finance to deal with a heavy return flow of securities from London. Redistribution of $150 million of Victory Bonds was achieved and an orderly market maintained. During the 1920's over 80 new investment firms were formed. In this period the upsurge of industrial development induced a large volume of corporate financing. The size of new issues increased and the industry rapidly developed the methods of underwriting corporate and government securities, which, while modified and improved, are still in existence today.

3. Subsequent to 1929 the industry underwent a period of trial as earnings, tax collections and

SUMMARY

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3. Subsequent to 1929 the industry underwent

security prices declined precipitously. The disruption of markets which occurred when Britain went off the gold standard caused a serious crisis and impressed dealers with the need of speeding up the distribution of new issues. In general, the decline in volume of new issues in the 30's led to a greater emphasis on secondary market trading, a concentration on security analysis and an increasingly sophisticated approach to financial matters resulting in part from detailed work done on corporate re-organization and debt re-adjustment.

4. During the 2nd World War the securities business was centred in the work of the National War Finance Committee. In the war period over 23 million subscriptions were obtained for the various loans which totalled $13.1 billion.

5. As the post-war period began, the industry was convinced by its wartime experience that there could be a large increase in the securities business. Low interest rates, inflation, the liquidity of investors based on government bondholdings and the favourable economic environment encouraged a strong trend toward equity investment. Increased financial capacity and the employment of more highly trained staff enabled dealer organizations to underwrite and distribute larger issues and generally to expand their business.

6. The post-war period saw the Bank of Canada become the dominant factor in the high-grade bond market. Since the Bank introduced the money market

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4. During the 2nd World War the securities business was centred in the work of the National War Finance Committee. In the war period over 25 million subscriptions were obtained for the various [illegible] billion.

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in June 1954, investment dealers have generated a large volume of trading in short-term securities. The 1950's saw a great expansion in the sale of Canadian securities to foreigners. The post-war period illustrated again the ability of the industry to adjust to changing conditions, demands for funds and investor preferences.

7. As at December 31st, 1961, The Investment Dealers' Association of Canada (I.D.A.C.) had 189 Members directly employing 9,329 people, of whom 14.5 per cent were partners and directors. A survey in August 1958 showed the industry employing 8,589 people in 196 firms. Thus, in this period, while membership declined by 7 firms, the number of personnel increased some 8 per cent. These figures indicate a trend in the industry toward rising employment based on the need for a larger number of office workers, analysts, traders and the like to support each salesman. 110 I.D.A.C. members have staffs of 25 or less and of these some 60 employ less than 10 persons. In the main these small firms have been built on the knowledge, capital and sales ability of a few senior partners.

8. Appendix A (part 1) describes the internal organization of an investment house. One important common denominator of all firms except those few which are controlled in the United States, is that without exception the officers, partners, and directors actively participate in the business.

9. The investment business in Canada is characterized by the great variety in the size, type of business, and the kind of clientele of the various

firms. Broadly speaking, the integrated houses are the large national firms which underwrite, distribute, trade, and evaluate practically all types of securities. Distributing houses do not customarily originate industrial issues but participate in their distribution and carry on trading in outstanding securities. Specialty houses are those which restrict their business primarily to such areas as unlisted stock trading or buying and dealing in municipal or religious issues.

10. Underwriting is a principal function of the investment dealer. The dealer underwrites by buying all or part of an issue for his own account or jointly with others, by winning a public tender for securities and by negotiating new issues. While not underwriting in a strict sense other methods of acquiring new issues used by underwriting houses include arranging private placements and acting as agent for issuers. Underwriting firms form a key group in the list of primary distributors which the Bank of Canada uses for offering new Government of Canada issues. In provincial issues large national underwriting syndicates may negotiate for the purchase of the issue or in the case of smaller issues several such syndicates may bid at public tender. Municipal issues are bought by underwriters through public tender or purchases arranged by private negotiation. Government of Canada money market issues are dealt in primarily by 14 investment dealers and the chartered banks. The Treasury Bill segment of this market represents a large volume of transactions at very small margins. Bills are tendered for each week

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at public auction. Corporation issues are generally underwritten after direct and private negotiations between an underwriting house and the company. In these issues the investment dealer assists in designing the issue in accordance with the requirements of the company and the current preferences of the market. The underwriting function as applied to the various types of securities outlined above, is described in detail in Appendix A (part 1).

11. Another major function of the investment dealer is that of trading in outstanding securities. Through his trading activities the dealer establishes and maintains markets and thus provides liquidity and establishes value levels for securities not listed on exchanges. Most dealers active in secondary markets carry inventories which enable them to conduct an orderly market and to deal in the size required by financial institutions. The street market of the dealers is handled by their traders. The larger firms will have a number of traders who may specialize in money market securities, Canadas, provincials, corporates and unlisted stocks. This trading is done through a network of direct telephones and other communications facilities on a truly national basis. The kingpin of this market is the Bank of Canada whose prices and actions with respect to money market securities and Government of Canada bonds provide the bench for the "government" market and for the evaluation of lesser securities. While market information is passed on by word of mouth, printed information, primarily quotations is disseminated

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[illegible]

regularly by some 25 dealers and the I.D.A.C.

12. A third and increasingly important function of the investment dealer is the provision of a variety of services. Advice to buyers, sellers, and issuers of securities is given through interviews, telephone communications, memoranda, analytical reports and the like. In addition, the dealer's growing business and the increasing sophistication of his clients is requiring provision of more information in the form of economic and industry studies, market commentaries, offering lists, notification of called bonds, etc. Portfolio management services are offered to clients by a number of dealers. The rapid growth in the demand for these services in recent years has necessitated that dealers expand their research and clerical staffs.

13. In contrast with other financial institutions, investment dealer organizations are small and characterized by a high degree of independence and individuality. Over the years they have adapted themselves to changing conditions in a manner which has resulted in a continual broadening of the Canadian capital market. Mr. J.E. Coyne, then Governor of the Bank of Canada, in a public address made on December 14, 1959, stated:

> ".... we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, local authorities and business corporations. This is primarily the field of activity of investment dealers. I think there is little

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doubt that the financial machinery existing in Canada for the placing of new issues of securities on the market is the equal of that of any country in the world and, in proportion to our size, it probably arranges, year in and year out, for the provision of a greater quantity of new capital to those requiring it than is the case in any other country in the world. The results achieved are a reflection of the industry and enterprise and broad national outlook of our investment dealers...."

The Association - Appendix A (part 2)

14. The Association (The Investment Dealers' Association of Canada) was formed in June 1916 under the name of the Bond Dealers' Association of Canada with 32 members. By 1920, membership had grown to 104 and in 1939 there were 130 members. Peak membership of 206 was reached in 1958 and since this time membership has declined to 189. In 1925 the name was changed to the Investment Bankers' Association of Canada but with the passage of the Bank Act in 1934 use of the word "bank" was restricted and the name of the Association had to be changed to The Investment Dealers' Association of Canada (I.D.A.C.)

15. Membership in the Association is governed by its constitution and by-laws. Membership is open to all those carrying on business as investment dealers if it can be shown that at least one-half of their gross

profits result from underwriting, distributing or buying and selling investment securities in Canada. It is required that at least 50 per cent of the partners or officers and directors must have been in the investment business for at least five years. Minimum standards varying with the type and size of the business are set to prescribe the amount of capital each member must maintain. The by-laws of the Association have been continually amended to reflect the changing standards and requirements of the industry.

16. The I.D.A.C. is organized on a national basis and for its purposes Canada is divided into six districts with the chairman of each district executive committee being a vice-president of the Association. Each district has a Business Conduct Committee, and there is a National Business Conduct Committee. The National Association has a permanent executive staff at its head office in Toronto and at its branch office in Montreal. The I.D.A.C. is not directly comparable with associations in other countries.

17. A principal function of the I.D.A.C. is the protection of the investing public by endeavouring to maintain the highest standards of ethics and reliability. As a control the I.D.A.C. makes all members subject to periodic routine reviews of the type of business they conduct. The I.D.A.C. also devotes considerable time to the protection of its members and to the advancement of Association objectives by taking a broad interest in economic, legislative, tax and other matters. This brief is an illustration of that interest. While day-to-

[illegible]

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day control over securities trading is carried on by the Bond Traders' Association of Toronto and Montreal, the I.D.A.C. exercises ultimate responsibility for regulating secondary trading.

18. Another prime function of the I.D.A.C. has been to provide education on investment matters for employees of its members and for the general public. Since the inception of the employee education programme in 1947, 5,996 persons have enrolled in the two courses provided and 3,601 have successfully completed at least one of these courses. A third course is now being prepared which is designed to improve employees' knowledge of the banking, accounting, contractual, regulatory and legal aspects of the investment business. Each year the I.D.A.C. has distributed through several universities a home study correspondence course entitled "How to Invest Your Money in Bonds and Stocks". A total of 20,000 persons have enrolled in these courses. Also in co-operation with universities and school boards, the I.D.A.C. has established lecture courses in which 1,700 Canadians were enrolled in 1961. By using voluntary speakers panels composed of members, the I.D.A.C. now provides about 100 public addresses a year for various organizations. Its film "A Matter of Importance" has received over 300 showings since it was produced in 1954. Through these and other means, the I.D.A.C. is making a serious effort to improve the public's knowledge and understanding of investments and the investment business.

19. Apart from occasional surveys, the I.D.A.C.

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has not been a statistics gathering body. The year-ends of its members are scattered throughout the calendar year and no two firms keep their books in the same way. It may be desirable in the future to standardize accounting practices to a greater degree. This would make the regular collection of statistics feasible. The I.D.A.C. does make a contribution by gathering and assembling figures on member borrowings outside of the banks, and, in co-operation with D.B.S., by assembling and distributing information on the sales and purchases of securities between Canada and other countries. Each business day the I.D.A.C. makes available quotations on a large and representative list of bonds and debentures traded in Canada. The I.D.A.C. has prepared and produced a number of publications which have been found to be valuable within and without the industry. Copies of these are exhibited.

20. In addition to these specific functions, the I.D.A.C. has made important contributions by virtue of its liaison activities with many bodies such as the Canadian stock exchanges and the Canadian Bankers' Association.

FINANCE DEPARTMENT & FEDERAL & PROVINCIAL FINANCE - Appendix B

21. The Second World War brought about such great changes in the Canadian debt structure and in debt management that study of pre-war conditions would have no real significance. Also, the inflationary forces created during the war, together with the deferred

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demands for all forms of social capital, both from within Canada and from foreign countries, greatly stimulated capital expenditure. Low interest rates and rapid economic expansion induced a vastly increased volume of Canadian and foreign investment into the equity field. The public tended to reduce the proportion of federal government bonds in their portfolios and there was a growing reluctance on the part of many investors to apply more than a limited portion of their funds to long-term bonds. While certain important institutional groups are obliged to buy fixed income securities, even these tended to apply higher proportions to better yielding securities and equities. These developments have tended to narrow the market for long-term Federal Government bonds.

22. In the latter part of the 1950's, the government accepted the principle of deficit financing as a stimulus to a lagging national economy. Lack of investor interest in long-term debt securities necessitated the government financing its requirements largely in the short-term market and through Canada Savings Bonds, which latter, now comprise 22 per cent of the government debt. These activities have tended to distort the bond market and reduce the liquidity of long-term Bonds. The increasing dependence on financing through Canada Savings Bonds, which are in effect demand obligations, rather than through term issues, is a regrettable trend.

23. The root of the problem is fiscal policy. It would probably have been impossible to finance the

large deficits of recent years by other means. Fiscal policy should direct more attention to debt retirement in periods of prosperity. This, combined with provision of a fixed annual sinking fund of 1 per cent per annum on all outstanding federal government issues over three years, would provide the market with the confidence it needs.

24. It appears that there is a tendency for debt management policy to be unduly subordinated to monetary policy and it is suggested that the Royal Commission inquire as to whether debt management and control of currency have conflicting interests and whether these functions should be separated.

25. It seems appropriate to study the possibilities of returning to an administered Bank Rate, which would clearly indicate the state of the Canadian economy. In order to foster the growth of the money market, the money market participants should continue to have the right to sale and repurchase agreements with the Bank of Canada, at the average weekly rate established at the tender for 90-day Bills, plus $\frac{1}{4}$ of 1 per cent.

26. In the last five years large federal government deficits have necessitated substantial increases in debt. Now, out of a total debt of $18.6 billion, only $8.4 billion or 45 per cent is for a fixed period of over 3 years. Nearly $4.1 billion or 22 per cent consists of Canada Savings Bonds. Savings Bonds are designed for individual investors of modest means. They encourage the ownership of liquid assets by a large number of families who might not otherwise be

inclined to save. Thus they play an important part in Canada's financing. However, in view of the large amount now outstanding and the high cost of this type of financing, we suggest that the Government should place less emphasis on financing through this type of medium and that the maximum to any one buyer be limited, consistent with maintaining a true savings instrument.

27. In Appendix B, a comparison is made between methods of financing short and long term government and provincial securities in Canada with the methods used in Great Britain and the United States. The Canadian methods appear to be well suited to the requirements of this market. Indeed,they represent a combination of adoption and evolution starting during the First World War and the result seems particularly appropriate for our requirements. The syndicate method of negotiating for, or bidding on, provincial issues has evolved into a very satisfactory method of purchase and distribution. However, ways and means could be found to improve the liaison between the investment community, the Finance Department and the Bank of Canada which could probably result in more efficient and effective marketing of new Government of Canada issues. To achieve this objective, a standing committee on the marketing of government bonds should be stablished by Government decree.

28. Because of the Federal Government's control of the money supply, the dangers of it relying on short issues and Savings Bonds are not as great as is the case with the Provinces. In the main, it would seem

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BANK OF CANADA - Appendix C

29. The recommendation of the Royal Commission on Banking and Currency in Canada under the Chairmanship of Lord MacMillan prepared the way for the establishment of the Bank of Canada and the delineation of most of its functions. It soon became evident that while the Bank should have freedom in implementing monetary policy, such policy must be in agreement with that of the Government. The unhappy events of 1961 suggest the need of a formal procedure to solve disagreements between the Government and the Bank on both fiscal and monetary policy.

30. The original Bank of Canada Act (1934) provided that the Bank was responsible for debt management, but it did not actually become the Government's agent until 1938. Since this time and particularly with the growth of the welfare state concept, debt management has tended to cause a conflict of interest for the Bank. The Bank's objectives are "to regulate credit and currency in the best interests

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30. The original Bank of Canada Act (1934) provided that the Bank was responsible for debt management, but it did not actually become the Government's agent until 1938. Since this time and particularly with the growth of the welfare state concept, debt management has tended to cause a conflict of interest for the Bank. The Bank's objectives are

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of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion". Debt management has periodically hindered the Bank in carrying out these functions.

31. The placement of new Government Canada issues is carried out by a number of different methods, normally through primary distributors including the Chartered Banks, members of the I.D.A.C. and other brokers and dealers. Most of these distributors do not normally take positions or make markets in Government securities. We contend that consideration should be given to reducing the unwieldly list of primary distributors to those who regularly operate in this field. In some new issues, the amount being publicly offered is unknown due to Government or Bank subscription. This causes uncertainty particularly in view of the fact that such bonds may be re-offered at a later date, since the adequacy of the pricing and the judgment of the market's ability to absorbe an issue depends to a large degree on the size of the issue. On occasion the Bank has acquired the entire amount of a new issue at the advertised price and subsequently sold the bonds to primary distributors at a higher price. Such techniques are undesirable in our view. To a considerable degree these unorthodox activities have been necessitated by the Government's

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heavy cash requirements.

32. The statistical material provided by the Bank is invaluable to business and government. More frequent publication of explanatory material would be helpful.

33. The MacMillan report emphasized that the Directors of the Bank should be men of experience, skill and integrity. Our investigation indicates that less than one-half of the man years served by the outside Directors of the Bank have been served by men whose background was related to financial business. In the future more emphasis might be laid on the selection of men with experience and skill in financial matters.

34. The Bank's most important function is to influence economic conditions by effecting changes in Chartered Bank cash positions. As important and related objective is to broaden the market for Government securities and the Bank has taken a number of forward steps to increase the liquidity of the market. A further step in the form of extending bank lending facilities to selected dealers on collateral now beyond the term of the money market might be explored.

35. Open market operations are a traditional tool of implementing Central Bank monetary policy ahd these operations are more effective if the securities markets are broad and resilient (see definitions Appendix F). The Bank can effect such operations by buying more or less at weekly bill tenders as well as by operations in the securities markets. At times the Bank seems to have underestimated the psychological results of open

heavy cash requirements.

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market dealings. Since the bill sector of the market is broad and resilient it seems logical that the Bank should conduct its open market operations primarily in the short term sector of the market. In periods of crisis when disorderly markets may occur, there may be occasional need for the Bank to transact business in longer maturities.

36. In connection with Bank trading, it should be pointed out that its traders in the financial centres of Toronto and Montreal are not given sufficient authority and discretion. Also, its trading departments are understaffed. Although they will deal with all dealers some pressure is removed from Bank traders by virtue of the $250,000 minimum on Bills and bonds due within three years and a $100,000 minimum on other transactions. But consideration should be given to limiting trading of the Bank to these organizations which endeavour to make markets regularly.

37. The Bank of Canada is responsible for operating Government accounts and funds such as the Securities Investment Account, (which is used to invest surplus Government cash) and the Unemployment Insurance Fund. Operation of the latter has in the past frequently necessitated buying or selling action which was contrary to the Bank's monetary policy. Due to portfolio changes in 1961, this is no longer such an important factor. The Bank also operates The Purchase Fund for the Government. The market has been unsettled by the knowledge that securities in this and other funds might be re-offered at any time. This trading can have

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important affects on the banking system and also can be confused with open market operations and thus be unnecessarily disquieting to the market.

38. When the Bank purchases or sells exchange, it may contract or enlarge Chartered Bank reserves. Until recently, exchange reserves have been sufficiently steady that the Bank's operations in the exchange market have had no significant effect on the Canadian economy. Since the declaration of the Government Exchange Policy in 1961, substantial changes in this fund have occurred. Dislocations in the exchange market have resulted. A full examination of this area of the Bank's responsibilities and operations would be desirable at this time.

39. Since 1954, the Bank has had the power of regulating the cash reserves of the Chartered Banks and since 1955 secondary reserves have been required. It would seem that the agreement that requires secondary reserves is now at best of doubtful value.

40. Traditionally changes in the discount rate signal changes in the intention of the Central Bank and touch off adjustments through the entire interest rate structure. To our knowledge, Canada is the only country where this is not true today. Because the discount rate is tied to the bill rate, changes in it have little psychological impact. While the Bank can effect moves in the discount rate by buying or selling Bills, other central banks employ both open market operations and discount rate adjustments to indicate their policies and intentions. It is suggested

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that the Bank return to an administered rate.

41. The Bank's monetary policies would be more effective if other institutions which accept deposits and make loans were subject to regulations equally effective to those which the Bank exercises over chartered banks. It is further suggested that the Commission consider whether powers should be given to the Bank to influence margin requirements, terms of instalment purchase, term lending by banks and cash reserves of "near" banks. The Bank's ability to deal with these sectors is at present largely dependent on its powers and moral suasion. While most of its attempts at suasion have been successful, occasionally its objectives have not been attained. Failure in this area can prove to be embarrassing.

42. Even under the most harmonious fiscal and monetary politices, actions of the Bank can never provide a perfect solution for Canada's economic problems. It can only act in a broad and general manner to bring about an atmosphere more conducive to the attainment of desirable economic objectives. Occasionally, in the interests of orderly markets, actions must be taken which tend to controvert monetary policy. Bank effectiveness is severely limited in periods where fiscal policy must take precedence over monetary policy. The emphasis of the Canadian economy on international trade implies that deficit spending or expansionary monetary policy does not have as strong an effect as many might expect. Such policies have little influence on foreign demand for our products

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and indeed, in so far as they may influence costs and prices, could even reduce this demand. On the other hand, such expansionary actions are dissipated to a considerable degree by substantial imported goods. With these limitations in mind it is urgent that government return to fiscal orthodoxy as soon as possible. Cyclically balanced budgetary policy is needed to bring fiscal and monetary policies back into harmony.

MUNICIPAL FINANCE - Appendix D

43. The Canadian municipality is responsible for matters which primarily affect local residents. While education is considered a provincial responsibility, facilities and teachers are provided by the municipality. Municipalities owe their existence and authority to the provinces. The special sphere of operations of the municipality necessitates discussing its capital financing separately from provincial finance.

44. The municipality's basic sources of capital are current revenues, grants from senior governments and the proceeds from the sale of debentures. The rapid population growth since 1945 combined with the demand for higher standards of services has resulted in increasing municipal capital requirements. In some provinces, provincial corporations have been established to buy municipal debentures and in some others annual grants covering a percentage of annual service charges on debentures are provided. Such assistance has aided municipalities in obtaining their capital require-

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ments and in holding down their borrowing costs.

45. The traditional method for a municipality to raise capital is by selling debentures. Normally, the established municipality with a moderate capital borrowing programme will achieve good results by calling for tenders. However, a municipality with a heavy borrowing programme may be well advised to market issues through a fiscal agency group. Cities such as Ottawa, Hamilton, Vancouver and Toronto have followed this practice from time to time. Fiscal agencies may also be best suited for new municipalities and those in special circumstances or difficulties. A fiscal agency ensures that issues are properly prepared and well marketed. Sometimes calls for tenders are sent to only a small list of dealers. Such notices should be published in an official gazette so that all dealers will have an opportunity to tender. In general the bid that provides capital at the lowest cost should be accepted.

46. Municipal debentures are evaluated by comparing them with the issues of other borrowers. This comparison necessitates a lot of information and statistics. Of prime importance are information and statistics which will display the quality and diversity of assessment, the tax collection record, the weight of the debt and the debt history. Comparison is made difficult by the variety of bases of assessment and statistical information from province to province. Standardization on a nation-wide basis would be very helpful in evaluating municipal credits. In addition

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to the basic evaluation the investment dealer must consider such features as term, redemption clauses and coupon rates.

47. The chief markets for municipal debentures are financial institutions such as the chartered banks and trust companies which favour purchasing the shorter maturities and the insurance companies and pension funds which favour purchasing the longer maturities. Capital requirements of Canadian municipalities in 1961 were estimated at $471 million or about 46.5 per cent of total provincial financing in that year. Since the imposition of the 15 per cent federal withholding tax practically all of the capital requirements have had to be raised in Canada. This has denied municipalities the advantageous rates which were being obtained on external borrowings and tended to increase borrowing costs. Consideration should be given to rescinding this withholding tax.

48. Marketing of issues would be assisted if municipalities would refrain from offering true serials which result in odd principal amounts that are difficult to sell. In general, serials are difficult to sell to the public because there are so many different maturities. in the early years designed for sale to the banks and others, and a long term sinking fund maturity to satisfy the requirements of other institutions and the public. Sinking funds would create some demand for outstanding debentures and assist in making a market. The market for municipal issues would also be improved, if the Department of Insurance were to permit insurance

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companies to evaluate their holdings at the amortized book values as is the practice for federal and provincial obligations. Also, school debentures should be made eligible for deposit by non-resident insurance companies. In our opinion the issuance of tax exempt debentures in Canada would not result in a substantial improvement in the market or in significantly lower debt service charges.

49. The provinces have been increasing their assistance to municipalities. A simple but effective form of assistance is to require municipalities to provide the provinces concerned with information about their history and economic and financial condition. The provinces then distribute the information to dealers and very often incorporate it in tender notices. Another effective method of assistance is for the province to remit certain grants to the paying agents for the debentures so that these grants may be used directly in servicing the debt. This procedure has resulted in lower borrowing costs for the municipality. The market for municipal debentures has been assisted by purchase of parts of issues by various provincial accounts, but probably the most effective form of marketing assistance is the provincial guarantee of principal and interest payments. This is undoubtedly of major importance in marketing of issues of little known or low rated municipalities and school boards.

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CORPORATION FINANCE AND LEGISLATION - Appendix E

Corporation Finance

50. During the 10 years, 1949 - 1959, the number of companies tabulated by the Department of National Revenue rose from 35,706 to 86,996 and their assets from $21 billion to $63 billion. There are several assumptions which should be kept in mind in using these statistics but subject to these, 38 per cent of the application of funds of these companies over the period was derived from long term debt and equity issues. For the capitalization of the finance and utility segments of this group debt is a higher proportion of the total. In the manufacturing sector 60 per cent of the funds were generated internally, 12 per cent from the issuance of debt, 14.5 per cent from equities and 13.5 per cent from other sources. Over the 10 year period this tabulation showed capital expenditures of $11 billion with capital cost allowances contributing $6.7 billion or about 60 per cent. Reflecting this large contribution of internally generated funds, the working capital ratio of the group declined only slightly from 3:1 in 1949 to 2.7:1 in 1959. The percentage of debt in the capitalization increased from 12 per cent to 17 per cent. The trend towards higher proportion of debt in the capital structure was particularly evident in the case of smaller companies where there is a strong desire not to dilute ownership and to achieve leverage. Smaller firms also showed a noticeably higher proportion of bank borrowings in their capital structure.

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51. It is important to note that the cost of issuing debt in the post-war period has been lower than the cost of raising funds through issue of preferred and common shares. A rising corporation tax rate is responsible for this and the higher this rate the greater is the cost differential. At today's rate a company can afford to pay an interest rate of 8 per cent before the net cost exceeds a dividend rate of 4 per cent. At a 40 per cent corporate tax rate the interest-rate-equivalent of 4 per cent dividend would be reduced to 6.7 per cent. The pronounced tendency of corporate income tax rates to creep upward provides positive incentive for unsound corporate financing. The financial structure of companies varies according to size. Small companies tend to have more recourse to bank and mortgage financing and to retain a higher proportion of profits. These differences reflect the ease with which large companies can obtain funds in the market.

52. Date published by the Bank of Canada on new issues of securities from 1949 - 1960 shows a total of \$8.8 billion being raised, of which \$5.2 billion was debt, \$.6 billion preferred, and \$3.0 billion common. Rights issues of the chartered banks and the Bell Telephone accounted for 28 per cent of the total new issues of common stocks. The proportion represented by debt varied from year to year but in the 1949 - 1956 period was 56.3 per cent and for the 1959 -1960 period 59.5 per cent of the total. During the period of this survey a number of new large companies were formed,

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53. A detailed description of the underwriting process in Canada is provided in Appendix E Paragraphs 17 to 34. In addition, the dealer often acts as agent for the issuer in privately placing securities with institutions. Lower commissions are charged for private placements as the expenses and risks are much lower. Occasionally, small issues are underwritten on a "best efforts" basis with the dealer receiving a straight commission on the sales made. A major underwriter has the responsibility of providing sound advice on the best terms and lowest overall costs of an issue. He must also provide the placement power to sell the issue, and, in doing this, must correctly represent to his clients the quality of the issue and the degree of risk.

54. A study of the distribution of holdings of corporate and other non-Government bonds indicates that domestic institutions and pension funds provide the largest market. Among this group the life insurance industry is the most important buyer. In 1954 this industry held approximately 35 per cent of the outstanding total amount of these bonds but by 1959 this had declined

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to 29 per cent. This trend indicates that problems of distribution are becoming more complex and that the investment dealer is having to develop other markets.

55. The cost of issuing securities varies with the size of the issue and the degree of risk. Legal fees, prospectus preparation and production, research and sales expenses are more or less fixed regardless of the size of the issue. Risks are greater on securities of small or new companies. Both the risk and expense factors mean higher costs on small issues. Comparison of figures in tables 4 and 5 (Appendix E) which show Canadian and S.E.C. data, indicate that underwriting cost of small issues under $3 million are lower in Canada than in the U.S. and somewhat higher on issues over this amount. A Moody's study of U.S. utility issues shows spreads of from .10 per cent to .17 per cent while issues of Canadian utilities with similar ratings showed spreads ranging from .11 per cent to .17 per cent. Despite these similarities there are fundamental differences between the two markets. The size of the financial institutions in the U.S. is such that large issues can be sold to a small number of buyers, whereas in Canada most issues are sold to a large number of institutions and individuals. This means that costs of distribution are significantly higher in Canada.

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prices but there is reason to believe that this may not be true. In a survey of 16 comparable pairs of issues, 11 of the comparisons showed a yield to the public and yield cost to the company to be lower for negotiated sales. The fiscal agent maintains a continuous relationship to the Company and is in a position to assist in determining the timing and terms of an issue. He can also test the market ahead of time which is a distinct advantage. In competitive bidding dealers are required to bid on short notice without the benefit of advanced preparation and full and detailed knowledge of the Company's position and therefore, they tend to allow for unforeseen contingencies. On this subject Judge Medina has commented that the advantages to an issuer of a continuing relationship with a good investment banker are obvious.

57. Canadian companies either gradually write off expenses and discounts on issues, or charge them at once to earned surplus. These charges are not deductible for income tax purposes. To the extent that these charges represent underwriters' commission we feel strongly that they should be a deductible item as they are a cost of raising funds.

Legislation

58. Securities legislation in Canada involves 10 provincial securities acts, various provincial companies acts, the Companies Act of Canada, the Ontario Corporations Information Act and the Quebec Companies Information Act. There has been a movement toward

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achieving uniformity in this mass of legislation which movement has been encouraged and endorsed by the IDAC. The provinces are currently studying a uniform Companies Act and 4 provinces now have identical or nearly identical securities acts. There would seem to be large advantages to the investing public and the investment industry in enacting uniform securities legislation and administering it in a uniform manner. In the U.S. there are two Federal acts and in addition 48 states also have securities legislation. It would seem likely that if SEC-type legislation were established in Canada it would not replace existing provincial statutes but would be superimposed on these. The Association believes that such superimposition would not in the best interests of our capital market.

59. It would seem desirable that the various securities acts should permit the production and distribution of a preliminary prospectus in Canada as is the practice in the United States. This would permit more orderly marketing of new issues and give security purchasers more time in which to study them. It would also be helpful if all regulations affecting the underwriting and sale of securities were promulgated to the I.D.A.C.

60. The I.D.A.C. has strongly asserted that in the interests of justice provision should be made for arbitration and independent appraisal by provincial governments desiring to expropriate electric utilities. It would seem desirable that the temptation to expropriate arising out of the Federal tax treatment

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of the provinces should be removed. Also, certain mergers and amalgamations may be beneficial to Canada but the I.D.A.C. deplores certain recently employed "take-over" techniques.

61. A company incorporated under the Companies Act of Canada is a natural vehicle to carry on business in several provinces. However, this Act contains several anomalies which tend to deter incorporation and to create unnecessary delays and expenses. This Act should be reviewed with a view to eliminating these anomalies.

THE SECONDARY BOND MARKET - Appendix F

62. Through the secondary market, previously issued securities are transferred from one investor to another. Those normally participating in this market are Bank of Canada, chartered banks, Members of the I.D.A.C. and a number of other brokers and dealers.

63. The secondary market is large and active and absolutely vital providing a mechanism for investment and dis-investment. In 1961 the volume of sales of I.D.A.C. members, exclusive of primary market sales, $15.9 billion and their average quarterly inventories were $337.6 million (see table 1 appendix F). This active market ensures liquidity and establishes a spectrum of values. The substantial difference between mortgage and bond rates is primarily the result of the liquidity provided by the secondary bond market. The breadth of this market also greatly facilitates the open-market operations of the Bank of

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Canada and the dealings of the various Government accounts.

64. Up to 1917, the markets for Canadian debt securities were concentrated in London and New York. The large Government financing of the First World War and the corporate financing of the 1920's necessitated and encouraged the growth of a highly developed secondary bond market.

65. The Trading Departments of many dealers are regarded as the nerve centres of their operations. Vast networks of private wires, telephones and other public services are utilized to maintain contact with, and to trade in, national and international markets. These networks enable the industry to give adequate service from coast to coast and literally to draw upon the savings of the nation.

66. A number of dealers customarily act as principals and their willingness to assume liabilities in accordance with future trends of the market, as they judge it, does much to moderate market swings. The positions they take also permit trading in the size required by insurance companies, banks and other institutions. Some 30 to 40 dealers make markets in the vast majority of the securities traded, do the bulk of the trade and carry most of the inventory. These are the dealers to whom financial institutions, the Bank of Canada and other dealers look for prices, bids and offerings. The ability of these delaers to provide trading services would be improved if a larger number of financial institutions made a

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practice of lending bonds at reasonable rates.

67. Secondary market trading in debt securities has not attracted restrictive legislation as the industry has demonstrated its competence in self regulation. This is primarily due to the regulation provided by the I.D.A.C. and Bond Traders' Associations, which is described in detail in Appendix A part 1. The occasional misunderstandings and difficulties which have occurred have been dealt with quickly and responsibly by the industry's regulatory bodies.

68. The secondary bond market is customarily divided int two categories, one being the money market which is dealt with in Appendix G and the other consisting of all other securities, principally those maturing beyond three years. It is important that a broad and resilient market exist at all times for Government of Canada medium and long term bonds because these bonds provide the bench mark from which all other securities are graded. Investors look to the market for Government of Canada bonds for stability, quality and marketability. However, except for artificial support provided by the Government the long term Canada market has not had depth in recent times. For Provincial issues, the market tends to be narrower although the large issues of Ontario and Quebec receive broad public interest. In general, municipal bonds have limited secondary markets, and, except for the largest corporations, the supply of corporate bonds usually dries up shortly after new issues. The narrow spreads between bid and asked prices result

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from the keen competition between dealers and provides all investors with access to fair prices.

69. A characteristic of a growing economy in the large demand for funds in relation to the supply. The U.S. market is now the major source of foreign funds. It is therefore necessary for Canadian interest rates to be higher than comparable U.S. rates if funds are to be attracted to Canada.

70. The most significant domestic factors affecting interest rate trends in Canada, are the Federal Government's fiscal policy and the monetary policy of Bank of Canada. A fiscal policy, even on a long term cyclical basis, of balancing deficits with surpluses would provide a strong underpinning to the whole bond market. The recent policy of utilizing Canada Savings Bonds as a prime method of financing has tended to reduce the number of private investors buying bonds without redemption privileges. This is adversely affecting the breadth of the long term bond market.

71. Policies which will increase confidence in Federal Government securities are of major importance in stabilizing markets and in the long run, in improving the general functioning of the economy. Such policies include: determined effort to balance the budget and re-examination of the tax structure. The establishment of a specific mo nth for the Budget Address and regular reports on the Government's financial policies would remove some of the uncertainties from the market.

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73. The last section of Appendix F deals with the advantages and disadvantages of a bond exchange and concludes that the present dealer market provides with the most efficient service at the lowest cost.

"SHORT-TERM MONEY MARKET" - Appendix G

74. The money market, which began in 1954 when thirteen dealers were granted lines of credit has grown substantially since that time. This growth can be seen in the variety of borrowers presently competing for the available short-term funds and in the tremendous growth in volume since that time. This competition for credit and the rates offered have attracted many who had previously left them lying dormant for short periods of time to invest their short-term funds in the money market. The relatively high short-

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75. An increasing number of borrowers are raising part of their capital requirements in the short-term market. The Federal Government, since the Conversion Loan of 1958, has raised nearly all of its cash in the money market. The longer maturities issued by the government (excluding C.N.R.'s) during this time were all, with the exception of one issue, sold to the Bank of Canada for resale to the public.

76. Provincial and municipal governments have also found that the money market will provide them with additional sources of funds at a relatively low cost, while often allowing them to choose the most favourable time for financing in the long-term market. Finance companies regularly borrowed a considerable part of their requirements in the short-term market, but over the past five years, corporations have also become active sellers of paper. Because of these developments in the money market, the chartered banks and trust companies have been forced to become more aggressive in retaining deposits and in attracting new deposits.

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the short-term borrowings made directly by the provinces. However, there is no information available as to the amount of municipal borrowing in the money market or of the amount of corporate paper issued and outstanding. It is recommended that more detailed statistics be kept relating to all sectors of the money market. Appendix G examines in some detail the amounts of various short-term obligations presently outstanding in the market, i.e., (a) treasury bills, (b) Government of Canada and Guaranteed bonds maturing within three years, (c) provincial and municipal short-term obligations, (d) sales finance company paper, (e) corporate paper, (f) deposits accepted by the banks and trust companies.

78. The Floating Bank Rate, calculated weekly at $\frac{1}{4}$ of 1 per cent above the average rate paid for 91-day Treasury Bills, plays a practical and stabilizing role in the money market. The variable Bank Rate has encouraged the money market dealers to carry on inventory of government securities during periods of cash adjustment in the banking system, when day-loan facilities are not available. If the Bank of Canada returns to a traditional Bank Rate, it is recommended that a "Bank Accommodation Rate" or "Bank Lending Rate" be made available by the Bank of Canada to the money market dealers on a formula similar to the present Floating Bank Rate.

79. The money market dealers have developed an efficient market capable of transferring large amounts of short-term securities at narrow price spreads, and

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80. The increasing role of the "country banks" in financing dealer inventory is an important development in broadening the money market. The I.D.A. obtains statistics weekly from its members relating to the amount of inventory financed away from the chartered banks. This information is made available to the members of the Association, Bank of Canada and the Department of Finance.

81. At times, when the short-term rate differential between the United States and Canada is attractive to the non-resident, considerable funds flow into the Canadian money market. Since the introduction of the 15 per cent withholding tax on treasury bills on December 20, 1960, these flows

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have been directed towards the purchase of Canadian finance company and corporate paper. Canadian short-term investors will themselves place funds in the United States or abroad when rates are attractive. The question of withholding taxes on money market securities is dealt with in Appendix G. It should be pointed out that nearly all non-resident short-term investments are fully hedged. However, this is a factor influencing Canadian foreign exchange rates and, at times, money market rates, themselves, in Canada.

82. Our well-developed money market is contributing substantially to Canada's economic growth and the investment dealer organization has expanded to keep pace.

CHARTERED BANKS AND "NEAR BANKS" - Appendix H

83. The relationships between the investment dealer and the chartered banks and "Near Banks" are discussed in Appendix H. "Near banks" are defined as all institutions other than banks which receive deposits or make loans.

84. The nature of the investment business is such as to require continuous large scale accommodation from these institutions by way of call loans and day loans. Such loans are of high quality. During certain periods and particularly during the period from August 10, 1959 to October 11, 1960, chartered bank rates on such loans remained unacceptably rigid. Due to this lack of flexibility,dealers turned to "Near Banks" for accommodation. This development arose purely

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out of the need for a more competitive "price" on the large borrowings of this industry. We believe that the inflexibility of bank rates is in part caused by the 6 Oer cent ceiling. This ceiling does not apply to "Near Banks". It is recommended that the 6 per cent limitation be removed to permit the chartered banks more freedom to use a "price" basis as a deterrent to undesirable loan expansion.

85. Investment dealers use the facilities of banks extensively for deliveries and the like. Co-operation between the I.D.A.C. and the C.B.A. through the establishment of a joint committee would smooth out imperfections in this area.

86. Banks are the custodians of the bulk of the personal savings deposits of millions of Canadians. The bulk of bank security holdings mature within a five-year period and tend to be regarded as the temporary utilization of idle resources. Thus these holdings are very volatile, falling as commercial loans expand and rising as commercial loans decline. The possibility that personal savings deposits might be applied to a greater degree to long term security holdings and thus make a greater contribution to the economic growth of Canada should be explored.

87. The chartered banks through term deposit receipts are important issuers of securities. In our opinion rate changes on these securities have not been as responsive to changes in market conditions as is desirable.

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89. Considerable disagreement exists amongst our members as to whether bank participation in syndicates is in the public interest or serves any useful purpose. Some members believe that banks have a generally salutory effect by sharing the risks, providing accommodation, and by adding strength to the bids by buying for their own account portions of the issue. Others point out that undesirable conflicts of interest may arise as a result of bank participation and suggest that the primary function of banks is and should continue to be the provision of short term accommodation for their customers. The majority of our members do agree that involvement of banks in syndicates underwriting corporate securities should not be extended. It should be recognized that satisfactory performance of underwriting function is one of the

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principal contributions the investment dealer has to offer to the proper functioning of the whole capital market.

90. In distributing securities, banks enjoy advantages resulting from their widespread branch systems and special knowledge of customer resources. They have been a significant factor in the distribution of Canada Savings Bonds which we might point out involves no risk and is done at only incidental cost. Banks participate in selling groups on the same basis as dealers. The effectiveness of banks in distributing securities in small communities largely beyond the reach of investment dealers is acknowledged. However, important conflicts of interest can occur and at times individual bank managers may be inclined to discourage investment in order to maintain savings deposits. At such times as the banks are sellers of securities to meet expanding demands for loans it is particularly important that dealers have a strong sales force to handle the essential function of distribution.

91. As a result of the inadequacy and cost of chartered bank accommodation at various times, dealers have developed "near banks" as a source of funds. These institutions also provide funds for other financial intermediaries. They also issue a variety of securities. The size and importance of these institutions has grown in recent years and they have a significant impact on the market.place.

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RETAILING BONDS AND STOCKS and RISK CAPITAL - Appendix I

Retailing Bonds and Stocks

92. Bond sales up to the 1st World War were made primarily in foreign markets with domestic sales being confined to financial institutions and wealthy individuals. The Victory Loan issues of the War carried high interest rates and tax advantages which encouraged individual investment. During the 1920 - 1930 period almost $6 billion was invested in capital goods and the proportion of foreign capital drawn upon was considerably reduced. In this period, individuals participated in the security markets in an increasingly broad and active manner. The wide acceptance of the Victory Bonds of the 2nd World War was a result of educating a large selling force. In this period, the Payroll Savings Plan was developed. The Victory Loan campaigns of World War I_1 were responsible for millions of Canadians owning investment securities for the first time. Today there are over two million individuals in Canada who own Government of Canada bonds. These citizens are a stabilizing and supporting factor in the bond market. Continuation of the habit of thrift developed during the war is maintained by an annual Canadian Savings Bond campaign.

93. The small investor, whom we shall define as having up to $10,000 invested in securities, does not normally have much knowledge of securities markets. His investments are usually either exceedingly conservative or extremely speculative. The small size of his holdings severely restricts the degree of

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diversification he can achieve. The small investor is likely to be a good market for bonds but is unlikely to be a good source of capital for sound new enterprises. The investment dealer solicits his business and spends much time educating and assisting him.

94. The medium investor is an individual with between say $10,000 and $100,000 invested in securities. Quite often he is a professional or business man whose income is substantial andgrowing. On the other hand, the medium investor may be a retired person, a widow or a dependent who has inherited capital. Generally, this class of investor will be moderately well-informed but will tend to rely heavily on the advice of the investment dealer. The professional or business man is often in a high income tax bracket and therefore interested in capital appreciation. Much of the educational effort of investment dealers and the I.D.A.C. is aimed at the medium investor.

95. The large investor who has securities investments of $100,000 or more will normally be quite well informed. The cost of doing business with the large investor, relative to the return, is substantially below that with other groups. He provides a good market for all types of securities including stocks in risk ventures.

96. Investment dealers service the retail market by sending salesmen into the field. This is not true of banks and stock brokers. To service retail accounts it is of primary importance that the dealer have the knowledge and resources to study and underwrite the

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securities to be offered. He must also have a force of qualified salesmen, facilities to train these salesmen and capital to carry them until they become productive. The trainee will usually spend time in each of the operating departments, attend sales meetings, and complete at least one of the courses offered by the I.D.A.C. The dealer also requires a research department to supply salesmen with information and guidance, accounting and trading departments and a communication system. He may also engage in portfolio supervision and underwriting. Through the I.D.A.C. as well as through a broad variety of material he may produce himself, the dealer contributes to the education of the investing public. Provision of all these services means that the cost of doing retail business is high.

97. The dealer must acquire clients to expand his business. Most new investors come to dealers through referrals but, in addition, the dealer attracts them through advertising and through approaching them directly. However, in some provinces there are legal restrictions regarding approaching prospective clients at home except to sell Government Bonds and this can have the effect of somewhat restricting the development of new accounts.

98. It would be hlepful if the Government of Canada would give more consideration to the retail market when establishing the terms of new bond issues. Such consideration would provide a strong incentive to broadening the market for Government and other

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securities in Canada.

Risk Capital

99. All types and variations of securities issued for the development of new ventures must be defined as risk capital. Basically, there are two types of risk capital - that for long term investment in intelligent and seriously conceived new ventures, and that for short term investment in risky securities where quick profits are sought with little concern for the ultimate outlook of the enterprise. Many retail investors who do take an interest in well conceived ventures are inclined to ignore the ultimate potential and accept short term capital gains, if and when available. Thus, the equity in these ventures tends to shift from the public to institutions and foreign investors. On the other hand, the public will hold for long periods the securities of such enterprises as established utilities. Dealers are continually attempting to educate and interest individual investors in the long term development of new enterprises. Participation in such developments could be broadened if the shares of an institution such as the Industrial Development Bank were offered publicly. It is recommended that tax advantages be provided to encourage individual investment in risk ventures.

100. Raising long term risk capital is difficult. The investment dealer must do a great deal of work, sometimes on many companies, before he finds one of the size and promise suitable for public offering.

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Then he must, through sales meetings, field trips and the like, introduce this Company to his sales force. This is an expensive and time-consuming process. In order to protect clients, the underwriter must continue to take an interest in and make markets for the securities he has distributed. Where difficult conditions develop, the dealer will endeavour to protect his clients' capital by devoting a considerable amount of time, and sometimes his own capital, to the restoration of the enterprise to profitable operation.

STOCK BUSINESS - Appendix J

101. The stock business in Canada is largely carried on through the five stock exchanges, with the Toronto Stock Exchange and the Montreal Stock Exchange handling the vast majority of the business. These two exchanges listed a total of about 1,250 stocks at the end of 1961, at a quoted market value of close to $62 billion. Of this market value, about $31¾ billion consisted of stocks of foreign firms, mainly large United States companies. Excluding these foreign stocks, trading activity in 1961 represented about 8.6 per cent of the quoted market value of the Toronto Exchange. If adjustment is also made for that portion of the stocks which are closely held, trading activity would have represented about 12.3 per cent of the supply available to the market. In recent years there has been a growing number of secondary distributions of large blocks of stock.

102. Stock trading is done on an agency basis

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with commission rates as set by the exchanges being charged for buying and selling. Commission rates were revised upward in 1945 and subsequent tothis, changes have been primarily modest upward revisions and re-classifications. Demands for added services in the post-war period have been such that the cost of consummating stock business has risen rapidly.

103. A large over-the-counter market exists in Canada but the main volume of trading in this market consists of bonds and debentures, which are dealt with in Appendix F. The stocks traded in the over-the-counter market are primarily those of natural resource and specialty companies. A large number of dealers operate in this market, but except in periods of active development of new industries, such as uranium, over-the-counter activity is very small compared with that in the United States.

104. The supply of stocks available to the investor through new issues has been strongly influenced in the post-war period by the large proportion of capital expenditures which business has financed internally; foreign financing; the lack of certain growth industries in Canada, such as electronics; the growth of foreign-owned subsidiaries in Canada; expropriation of utilities by Governments; mutualization of insurance companies; increases in the corporate tax rate which provide incentives for debt financing and by inflation, which also provide incentives for debt financing and by inflation, which also provides incentive for debt financing. In recent years only about two fifths of the

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new capital raised by corporations has come from equity financing. On the other hand, the supply of new stock issued has undoubtedly been increased by the 1954 revision of the Bank Act, which assisted the banks in making rights offerings; the limited financial strength of certain companies which necessitates equity financing and by the need of utilities and other companies to maintain their equity bases.

105. The demand for stocks can be broadly divided into that arising from individual investors and that from various institutions. There is considerable overlapping however because some institutional demand, such as that of the mutual funds, arises directly from individual investment. In 1959, just over 9 per cent of Canadian families and unattached individuals owned stocks, with the primary incidence being in the higher income brackets. A United States survey in June 1955 indicated that 8 per cent of United States family units were stockholders. Thus the incidence of individual stock ownership is probably very similar as between Canada and the United States.

106. The information available on institutional stockholdings varies widely from one institutional group to another. In 1960, life insurance companies held only about 2.2 per cent of their assets in preferred and common shares although the statutory limits permit 15 per cent. A large portion of the stocks held were foreign and at December 31st, 1960, only .96 per cent of their assets were represented by Canadian common stocks.

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107. Fire and casualty companies, on the other hand, hold 7.2 per cent of their assets in Canadian and foreign common and preferred shares, a considerably higher portion than most other institutions.

108. Trust companies represent a very important sector of the demand for stocks. Of their assets, approximately 2.9 per cent was invested in preferred and common stocks at the end of 1960. However, 85 per cent of trust company funds are administered funds and on a large segment of these there is no published information. It can be assumed that a significant proportion of these administered funds are invested in equities. In this connection, it is interesting to note that in 1959 the personal trust accounts in United States banks and trust companies were over 70 per cent invested in equities.

109. Mortgage and loan companies, at the end of 1960, showed the book value of common and preferred holdings at 5.1 per cent of their total assets.

110. Pension funds provide a well-documented area of institutional investment. The asset distribution of the plans of incorporated companies show that equity holdings grew from $53 million in 1952, or 7.4 per cent of assets, to $239 million in 1960, or 12.3 per cent of assets. These industry plans made up about three fifths of total trusteed pension plans. Their emphasis on equities is as striking as is the lack of such emphasis in the investments of crown corporations and Government agency pension funds. In 1960, the holdings of all trusteed pension plans

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represented approximately 1.16 per cent of the value of all listed common stocks. It is estimated that the amount of common stock investments of all trusteed pension funds was $50 million in 1960, or about 12 per cent of net funds available for investment.

111. Investment companies of the open-end type are easily the most important source of demand for equities. Their net flow of funds into equities in 1959 is estimated at $80 million. At the end of 1959, the market value of Canadian stocks held by these companies totalled $472 million and represented about 2.28 per cent of the value of Canadian common stocks listed at that time.

112. In the post-war period, the investment by non-residents and non-resident institutions has had a very important impact on the demand for equities. At the end of 1958 the book value of the capital stock of Canadian comoanies, owned by non-residents, amounted to $9.3 billion, of which $6.8 billion represented direct investments. It is estimated that non-resident trading accounted for about one-fifth of the value of the shares traded on Canadian exchanges in 1959.

113. In the 1955-1959 period, N.R.O. funds and other foreign-owned portfolio purchasers acquired $887 million in Canadian securities. During the post-war period, there was a steady rise in foreign interests in manufacturing, oil, natural gas and mining and smelting and a steady decline in the interests of foreign investors in railroads and utilities. The direct foreign investment has been based primarily on a

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desire to gain access to the Canadian market, access to the Commonwealth market or access to natural resources, the latter often being associated with vertical integration. It is probable that without massive foreign participation, many of the developments so financed would never have taken place. In terms of technology, the contribution of non-residents is unquestioned.

114. It is important to observe that institutional holdings of stocks are heavily concentrated in a short list of well-known companies. While institutional demand has been rising sharply in recent years, particularly from investment companies and pension funds, in general, Canadian institutions apply a smaller percentage of their assets to equities than do their American counterparts. While individual holdings of equities appear to be similar in Canada and the United States it is clear that Canadians' indirect participation in the stock market through various financial intermediaries is weak in comparison with the experience in the U.S.

115. The role of investment management has become increasingly important in the Canadian economy since World War II. Both individual and institutional investors have become more knowledgeable and more demanding and investment dealers have experienced consistent pressures to provide more information and sophisticated analysis. The investment dealer has responded to the demands of growing numbers of university-trained analysts in institutions by occasion of his research department and to the demands

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of individuals by expanding portfolio management and advisory services. It is estimated that it requires 4-6 years to develop a university graduate to the status of a recognized analyst at a cost of some $40,000 - $50,000. This, in addition to the growing need for information services and communications, has greatly increased the cost of doing business.

116. Improvements in the quantity and quality of the services offered, have been hampered to a considerable degree, by the difficulty of obtaining detailed and regular information from Canadian corporations. In recent years, fortunately, many companies have become more public and investor relations conscious. There has been a noticeable improvement in the quality of annual reports and an increase in the number of companies issuing quarterly and semi-annual reports. For some companies and industries, further improvements are still needed.

117. The rise of investment clubs in Canada in the post-war period has been significant in developing public interest in stock ownership. These clubs provide an opportunity for members jointly to study securities, thus broadening their investment knowledge as well as providing a means of investing personal savings. Investment clubs do not yet have a great impact on the market and the smaller ones often deal in odd lots, which transactions are unprofitable to the broker. Nevertheless, investment dealers have encouraged them because of the contributions they are making to broadening the market for securities. In this area,

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MUTUAL FUNDS - Appendix K

118. Mutual funds, whose antecedents are the investment trusts of Great Britain, really began to develop on this continent in 1924 with the formation of Massachusetts Investors Trust and State Street Investment Corporation, the first of the open end investment companies. Between 1927 and 1930, over 700 investment trusts and holding companies were formed in the United States, nearly all of which were of the closed end type. Many of these concerns were highly leveraged and there was much pyramiding of one investment company into another with the result that many more or less collapsed in the 1929 stock market crash and the ensuing depression years of the 1930's.

119. In Canada, 49 investment companies, practically all of the closed end type, were in operation at the end of 1929 and had assets of some $265 million. While there were varying degrees of leverage there was very limited pyramiding with the result that the Canadian trusts were not as hard hit as their American counterparts in the 1929 panic. Most of them won through and are in operation today.

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121. Investor confidence in investment companies, however, was slow in returning. The first open end type of mutual fund in Canada was established in 1932, but it was not until 1950 that a strong investor preference for this type of fund began to appear. The last ten years have seen a rapid growth in the number and size of mutual funds. There are now 41 mutual funds of significant size in Canada of which 24 are Canadian owned, and hold essentially Canadian securities, four are primarily Canadian owned, but specialize in foreign securities, three are owned primarily abroad, but with Canadian investments, and ten are non-resident owned (N.R.O.) companies investing in Canadian stocks.
At the end of 1960 the total net assets of these funds was $900 million and at the end of 1961 was estimated to be about $1 billion. During the past ten years closed end type funds have been comparatively static while mutual funds have developed into an increasingly important position in Canadian financial markets.

122. A typical mutual fund has a simple capital structure consisting of redeemable special shares and a small number of deferred shares. The latter are held by the management group. Both classes of stock

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have equal voting rights. The special shares, which are redeemable at the holder's option, are sold to the public at the net asset value which is calculated daily, plus a loading charge of 8 per cent. Normally the load is reduced to 5 per cent for purchase of over $50,000. The bulk of this charge is paid to the investment dealer or to the sales force of the underwriter. A typical fund would be prohibited from borrowing money, buying securities on margin or selling short. Its investments would consist of about 70 common stocks of well-known Canadian companies and about 15 per cent of its portfolio would be in preferred stocks and corporate bonds. A typical company would pay dividends quarterly but would provide means for reinvesting the dividends in the special shares of the fund. It would be managed by a management organization which would provide office space, administrative and research staff and portfolio management services. The management fee would be one-half of one per cent of the average net asset value. Provisions would be made to ensure arm's length dealing by the management.

123. Mutual funds are subject to Section 69 of the Income Tax Act and N.R.O. funds to Section 70. Section 69 provides that investment companies pay a tax of 21 per cent of their taxable income providing they meet certain requirements, namely having at least 80 per cent of their property in, and 95 per cent of their income from, securities or cash. At least 85 per cent of their gross revenue must come from Canadian sources and not more than 25 per cent from

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interest. The fund must distribute in each yeat at least 85 per cent of taxable income. Not more than 10 per cent of assets may be in the securities of one corporation. In addition, it must have at least 50 shareholders, none of whom own more than 25 per cent of the shares. The N.R.O. company, under Section 70, is subject to a 15 per cent tax if at least 95 per cent of its shares are held by non-residents; if not less than 90 per cent of the gross revenues are from interest or dividends; and if no revenue is derived from business activities such as purchasing, merchandising, manufacturing and the like.

124. Mutual fund shares are normally offered for sale at their net asset value plus a fee or loading charge. A few funds have a low loading and exact a fee when shares are presented for redemption, but most funds charge about 8 per cent on sales price and no fee for redemption. Thus the loading covers both sale and purchase. If the spread between bid and asked prices of stocks traded on exchanges and the minimum commissions which stock exchange numbers must charge on small lots are taken into consideration, loading charges do not appear to be excessive.

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124. Mutual fund shares are normally offered for sale at their net asset value plus a fee or loading charge. A few funds have a low loading and exact a fee when shares are presented for redemption, but most funds charge about 8 per cent on sales price and no fee for redemption. Thus the loading covers both sale and purchase. If the spread between bid and asked prices of stocks traded on exchanges and the minimum commissions which stock exchange members must charge on small lots are taken into consideration, loading charges do not appear to be excessive.

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purchase plans under which a stated amount of money is invested at regular intervals. The latter may be on a voluntary or a contractual basis. Under the contractual plans some mutual funds concentrate a considerable part of the total load of the entire contract into the initial years of the plan with the result that if the purchaser terminates the contract in the earlier years of its life he may only recover part of the amount paid in. The great majority of regular purchase plans are used by small investors who contribute from $15 to $100 per month.

126. In 1957 the Income Tax Act was amended to permit the self-employed person to contribute to an individual retirement plan. Mutual fund shares qualify as media for such plans and this feature has provided a new and increasing outlet for their sales.

127. A number of funds provide "withdrawal plans" whereby a shareholder may liquidate a portion of his previously acquired block of shares at regular intervals. This processis not in any way the equivalent of the payment of an annuity and the shareholder has no guarantee that his capital will not be exhausted. While market experience over the past 11 years has been favourable to most of these plans, there can be no assurance or guarantee that this experience will repeat itself. For the unsophisticated, the plan can appear complicated and, unless explained by a highly experienced salesman, misunderstandings could occur.

128. The growth of mutual funds may be regarded as part of a broad trend toward equity investment by the

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public. Investment companies are media through which the small investor can share in the risks and rewards of equity investment while obtaining professional management, broad diversification and liquidity. That investors consider mutual funds attractive is illustrated by the growth of five representative Canadian funds which had assets of $50 million in 1950 and $555.5 million in 1961. (See Appendix K, Exhibit D.) It is obvious that these funds have tended to promote individual saving and encourage investment in equities. Also, these funds have tended to make the small individual investor more conservative in the sense that they have attracted his interest away from highly speculative commitments.

129. In Canada there is no special regulatory legislation for investment companies although all mutual funds are subject to the federal or provincial acts under which they are incorporated as well as to the securities acts of the provinces in which they sell their shares. Mutual funds in Canada have to date voluntarily set high standards of self-regulation. Nevertheless, an examination of these acts should be made to ensure that these provide adequate safeguards for the investing public in both open and closed and investment trusts.

FINANCING SMALL BUSINESS - Appendix L

130. Generally a worthwhile project requiring $500,000 or more can be financed with a debt or equity issue. Small business requirements are therefore defined as being less than this amount.

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131. The small business can sometimes raise funds by selling shares or notes to friends and business acquaintances of the entrepreneur. Occasionally, investment dealers will place an issue with a small group of clients or with one or two investing institutions out of the few willing to participate in private placement. In a survey reported on by 103 investment dealers there were 47 who had offered a total of 217 small business issues in the past two years. Of this number only 18 were private placements.

132. The Industrial Development Bank has been Canada's best answer to the problem of financing small business. The I.D.B. reports having 1,364 loans totalling $71.2 million for an average of $52,000 per loan. Loans are only granted on the security of fixed assets. In surveying the attitude toward the I.D.B. the following criticisms were encountered: that its services are too slow; costs too high; liens on assets too tight; repayment requirements too heavy and that there was a tendency to force small business into fixed obligations. In spite of these criticisms it appears to us that the I.D.B. is doing a good job.

133. The prime suppliers of short term loans to small business are the chartered banks. Also, under the Small Business Loans Act, the banks can advance up to $25,000 in certain small businesses grossing less than $250,000 per year. The Government guarantees lending banks to the extent of 10 per cent of the aggregate of such loans. Loans under this Act have not been as numerous as was originally anticipated. It has been

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indicated that the Government might increase the maximum to $50,000 and include businesses grossing up to $750,000. This would be advantageous. However, the Government should consider increasing its guarantee to 25 per cent of the aggregate loans.

134. Public distribution of the securities of small business is made difficult by the reluctance of the chief lending institutions to participate in small stock and bond issues. Thus, the underwriter must rely on the retail buyer. The large investment dealer cannot afford to handle small issues but if an issue has sufficient merit an investment dealer can be found to distribute it, if it is in excess of $200,000. Major problems which dealers experience in financing small business are lack of depth and experience in management; inability to withstand a recession; reluctance of the principals to accept partners; an insufficient amount of equity provided by the principals and the lack of marketability of small issues.

135. Certain industrial commissions assist small business through grants of land and communication of taxes and some private corporations have been set up to finance the small business. In the main, the latter tend to require too large a share in the common stock.

136. In Britain the Industrial and Commercial Finance Corporation plays a valuable role in financing small business. This corporation is sponsored by a group of banks. The shareholding banks provide all the funds for its purposes. In the United States the Small Business Administration has contributed importantly to

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financing of small business ventures. This Administration licenses, supervises and helps to finance investment companies which serve as sources of equity and long-term loans to small business. About 425 of these investment companies with capital amounting to $½ billion have been established. Subject to certain limits they may borrow up to 50 per cent of their capital from the Administration. Over 125 American banks are stockholders of these investment companies. Consideration should be given to establishing similar legislation in Canada.

137. It is important to emphasize that the largest pools of money in Canada, namely those of the banks and the insurance companies, are at present supplying no consequential amount of long-term funds for small business. If ways and means could be found to encourage these investing institutions to apply even a fraction of 1 per cent of their portfolio investments to the securities of small businesses, a major contribution would result.

NON-RESIDENT INVESTMENT - Appendix M

138. Appendix M deals with certain aspects of non-resident investment in Canadian debt securities. Non-resident investment in equity securities is dealt with in Appendix J.

139. Foreign investment in Canada rose from $7.1 billion in 1945 to $20.6 billion in 1959. In 1959 U.S. investments in Canada totalled $15.7 billion. During the period 1946 to 1949, Canada was a net

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exporter of capital but her dependence on imported capital increased during the 1950's and in 1959 over 29 per cent of gross capital formation was financed through foreign sources.

140. Direct investment accounts for approximately two-thirds of all foreign investment in Canada. In recent years, the U.S. has been the primary source of direct investment. Canadian tariff policy has encouraged foreign companies to open branch plants in Canada. The investment dealer has had little to do with direct investments as they have been almost entirely outside the realm of his operations.

141. In the area of portfolio investments however the dealer has responded to the huge demands for capital in Canada and sought out foreign markets for Canadian securities. Foreigners have, in large part, financed all the large pipelines, the development of the iron mines in Quebec, the Kitimat aluminum project, and, in a substantial part financed large hydro projects in most of the provinces and a great many municipal and provincial projects.

142. In the 1956 - 1960 period, external sales of new issues of provincial, municipal and corporate debt securities totalled over $2.8 billion. The major portion of these securities were payable in foreign currencies. External payment bonds are legal for many foreign investing institutions and were sold at yields below those of comparable Canadian pay securities. The latter are issued primarily for the Canadian market and while purchased by foreigners they are not

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nearly as acceptable to foreign institutions. The main foreign purchases of Canadian debt securities have been life insurance companies, pension funds, savings banks and the like. Non-resident insurance companies which write insurance in Canada buy Canadian pay securities to cover their liabilities. These purchases do not affect our balance of payments position.

143. It is interesting to note that the greatest flow of capital to Canada occurred when the dollar was at a substantial premium. This suggests that the exchange rate was a result rather than a cause of the capital flow. However large capital inflows in 1950 and 1951 were undoubtedly related to the fact that foreigners felt that the Canadian dollar was at an unnaturally low level.

144. Since 1950, yields on Canadian bonds have always been higher than those on comparable U.S. bonds. The lower interest cost of financing through external pay securities has appeared to be attractive to many Canadian borrowers. Undoubtedly yields in Canada during the 1950's were kept lower than they would have been by virtue of the large volume of securities sold in the U.S. Debt security sales were encouraged by the absence of Canadian withholding taxes on external payment bonds. Since late 1960 the Government has actively discouraged sales of securities abroad by asking provincial and municipal governments to finance at home and by imposing withholding taxes which reduced yields to certain foreign purchasers. This resulted

in a substantial decline in the sales of debt securities to foreign investors, and a rise in the proportion of Canada's balance of payments deficit being covered by direct investments.

145. A growing country like Canada may need to import substantial amounts of foreign capital from time to time to ensure a rate of growth consistent with national objectives. It would seem desirable that where foreign capital is required, it should be sought in the form of debt rather than equity. In so far as is possible, Canadians should be encouraged to participate in the ownership of domestic enterprises.

TAXATION - Appendix N

146. In 1939, all levels of government in Canada took approximately 20 per cent of the Gross National Product. By 1960, this had increased to 28.7 per cent of a vastly increased Gross National Product. With the background of rapidly increasing government spending in mind, it appears essential that the tax structure should be critically examined.

147. Growth of our economy depends on demand for the goods and services we produce. Growth is essential to the maintenace of a high level of employment. Today the heavy tax loads and the methods of applying them appear to have a profound effect on economic growth. Under these conditions, it is desirable that our whole tax system be re-assessed. At the present time, Queen's University in co-operation with

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the Canadian Tax Foundation is carrying out a study of the level and structure of taxation in Canada. While broad, this study will not encompass all of the areas which we believe should be examined.

148. The present tax system was formulated under pre-war conditions. Since that time, the Canadian economy has undergone substantial change. In addition to the United States, new large economic blocks have been formed which are influencing and will further influence our international trading patterns. It is probable that our tax system is quite unsuited to current circumstances.

149. The prime factor which should be kept in mind when considering the revision of the tax system is simplicity. In Canada today, taxes are not only high but also difficult to determine. Present patch work results in considerable effort being utilized in tax avoidance. Broadly speaking, the simpler the tax system the easier it will be for business to make decisions.

150. Another important goal in revising Canada's tax system should be to achieve a more equitable distribution of taxes - a distribution which would provide more incentives and less discrimination. We should strive for elimination of the various forms of doublt taxation. Certain groups such as co-operatives and credit unions should contribute their fair share of the tax load. Particularly careful consideration should be given to a reduction in the higher marginal rates of personal taxation which would increase

incentives. Is it right for an individual tax payer to pay higher rates than the largest corporations?

151. The use of indirect taxation to broaden the tax base should be carefully considered. In Canada almost 86 per cent of tax payers pay less than the average rate. If the revenues of government must be increased substantially, a broader tax base will be necessary. This could be achieved through indirect taxation. Indeed, it might be desirable to implement a higher sales tax in order that corporate income and personal income taxes might be greatly reduced. In Canada at present many individuals receive benefits but do not pay their fair share of the costs. This also applies to a number of corporate entities.

152. While taxation is punitive, it can be varied in such a way as to direct and encourage economic activity along desirable channels. Two important channels for Canada are those that would lead to increased exports and employment. An incentive of fairly large proportions must be granted to ensure that movement in the desired direction will occur. It might, for example, be desirable to permit industry to charge depreciation in excess of 100 per cent under certain conditions.

153. In studying Canada's tax system, a full examination should also be made of systems in other countries, particularly those countries where production of primary natural resources is extremely important. Consideration of the way these countries have orientated their tax structure to foster economic objectives might

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prove to be very instructive.

154. Problems relating to distribution of corporate surpluses might be solved in a better manner than at present. Existing laws necessitate much wasteful expenditure of time and energy in legal manoeuvres. Consideration could be given to establishing a basic flat tax at the corporate level on all distributions to shareholders with such distributions then being tax-free in the hands of the shareholders. The establishment of the dividend tax credit was a progressive move. Further steps toward the elimination of double taxation should be considered. While the dividend tax credit has been successful in encouraging Canadians to invest in equities, it has not noticeably induced corporations to finance through equity rather than debt securities. Corporation tax levels are apparently sufficiently high that they provide positive preference for debt financing.

155. Any full study of the tax structure should include a more precise definition of income with a view to differentiating between income and capital gains. For Canada a capital gains tax is neither necessary nor desirable. Capital gains taxes can cause severe market dislocations and the costs of their calculation and collection are high.

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development of natural resources. Absnece of such a privilege in Canada may have contributed significantly to the high percentage of Canadian natural resources which are foreign controlled.

157. A prime objective in planning the revision of our tax system should be to provide a system which will assist the orderly growth of the economy. The government has been inclined to use increases in income taxes as a means of controlling inflationary pressures in boom periods. There has been no compensating policy of reducing income taxes during recessions. Canada needs to discover a positive approach to taxation through which the tax structure will be more closely linked to our long term economic and fiscal objectives. This will necessitate a sweeping revision of the present Income Tax Act. It is essential that a thoroughly competent body study our tax structure and our needs with great care. In the light of this study such a body could suggest a new system or a general revision of the old one which would be compatible with the requirements of the new era in which we live. To achieve this end, we recommend the establishment of a Select Committee to study and assess the entire tax structure of Canada.

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APPENDIX	TITLE
A	The Industry (Part I) & the Association (Part 2)
B	Finance Department and Federal & Provincial Finance
C	Bank of Canada
D	Municipal Finance
E	Corporation Finance (Part 1) & Legislation (Part 2)
F	Secondary Bond Market
G	Short Term Money Market
H	Chartered Banks and "Near Banks"
I	Retailing Bonds & Stocks; Risk Capital
J	Stock Business
K	Mutual Funds
L	Financing Small Business
M	Non-resident Investment
N	Taxation

APPENDIX A

THE INDUSTRY AND THE ASSOCIATION

PART I

THE INVESTMENT BUSINESS - AN OVERVIEW

Origins and Development

1. The roots of the investment business go back to the 1880's, when the first securities houses were founded. At that time most industrial and commercial businesses were small in size, their capital needs were modest and the use of the corporate form was not wide-spread. There were relatively few Canadians with surplus savings who were seeking investment opportunities and most of the long-term capital came from the London market. Canadian dealers established connections with English banking houses and acted as agents in arranging the sale in London of Canadian municipal and other securities.

2. By the turn of the century investment dealer operations had grown to include arranging capital issues for corporations engaged in transportation, public utilities and manufacturing. For example, in 1899 we find a dealer inviting subscriptions for $300,000 of $100 per value 7 per cent preferred shares of Dunlop Tire and Rubber Goods Co. Limited. This issue was well over-subscribed and allotments were made on the basis of 1 in 10.

3. In the early 1900's, as a result of continuing economic growth, more corporations sought "outside" capital and investment dealers underwrote and sold quite substantial issues. Thus in June 1911 we find a group of three dealers offering $1,500,000 of 6 per cent First Mortgage Sinking Fund Bonds of Canadian

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Locomotive Company Limited. It would appear that these bonds were still in primary distribution in late October, 1911.

4. At that time costs of doing business were low and spreads were wide by today's standards and the sale of a new issue was a leisurely affair, usually spread over several weeks. There was no securities legislation nor prospectus requirements. Sales effort consisted of the preparation of a brief circular which was mailed to a relatively short list of known investors.

5. When War broke out in 1914 more than three-quarters of all new issues of bonds were still being placed in London. Within a year this source of funds had dried up and after a brief period of access to the New York market, Canada was forced to turn to domestic sources of funds to finance her War effort. In 1916, the 32 investment dealers then in business formed themselves into what is now The Investment Dealers' Association of Canada and set about organizing a Victory Loan sales campaign which reached eventually every town and village in the land.

6. The first domestic War Loan was offered in 1915, was over-subscribed and was followed by successful Loans in 1916, 1917, 1918 and 1919. In six Loans over $2.2 billion was raised from 2,845,171 subscribers -- an impressive sum for a country of Canada's size -- and marked the beginning of a new stage of development in our capital market.

7. In 1920 the Minister of Finance requested investment dealers and banks to form a Marketing Committee

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8. The upsurge of industrial development in the decade following the First World War was facilitated by the presence in the country of thousands of new investors who extended their purchases to include new issues of bonds and shares arising from the growth of railway and transportation systems, hydro-electric power installations and the establishment and expansion of resource development and secondary manufacturing industries. This was a period of great activity for the securities business and over 80 new investment houses were founded between 1920 and 1929. Some idea of the increase in new issue financing during this period is given by the following table:

	1920	1925	1929
	(millions of dollars)		
Federal / Provincial	126	319	139
Municipal	56	52	97
Corporate	46	126	298

9. This period saw the development of the syndicate system for underwriting and distributing new issues. As the size of individual underwritings grew, it became prudent for the investment dealer purchasing the

to stabilize the market for Victory Bonds. Heavy sales by Canadian holders of Victory Bonds and a fall in sterling exchange which triggered a return flow of Canadian securities from the United Kingdom, threatened to cause precipitous price declines. The Dominion succeeded in maintaining orderly market conditions and achieving a redistribution of some $150 million of "Vics"

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9. This period saw the development of the syndicate system for underwriting and distributing new issues. As the size of individual underwritings grew, it became prudent for the investment dealer purchasing the

securities -- sometimes known as "the house of issue" -- to organize a syndicate of dealers who would share the liability by agreeing to underwrite part of the issue, usually at a small increase or "step-up" from the original purchase price. Today this syndicate is called the "banking group". To be a banking group member a dealer must have the financial strength to undertake the liability. Larger issues require a greater selling effort and, in due course, we find the banking group inviting other dealers to join a "selling group," again at a step-up from the banking group price. The selling group dealers are each offered a participation or may be invited to place an order with the manager of the banking group. The selling group dealer's liability is limited to the actual amount of securities allotted to him. Most new issues have been and are underwritten in Montreal and Toronto but selling group members are selected from various parts of the country in order to secure the widest distribution possible.

10. The house of origin began to accept increasing responsibility for co-ordinating the sale of the new issue and for the maintenance of orderly marketing conditions while the issue was being distributed. These arrangements were not the invention of any one firm but evolved out of the conditions under which the dealers operated.

11. Subsequent to 1929 the investment business passed through a period of trial and tribulation. As the great depression settled upon the world, earnings and tax collections dwindled and security prices declined

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disastrously. Many municipal and corporation issues defaulted on interest payments and fear spread among investors. Investment dealers suffered heavy losses and many substantial firms hovered on the edge of insolvency. The sharp decline in securities prices which followed when Britain went off the gold standard in 1931 impressed upon the dealer community the importance of speeding distribution of new issues to reduce the time during which a new issue liability was carried. As the crisis passed, underwriting houses and investing institutions worked away at problems involving corporate reorganizations and plans for debt readjustment of municipal and provincial issuers. Many municipalities sought and obtained from investment houses which specialized in municipal debentures, advice and assistance with debt and financing problems. The decline in volume of new issues in the early 1930's led to greater emphasis upon activity in the secondary or between-dealer market.

12. Increasingly vigorous competition for what little business was available resulted in the dealer becoming more competent in appraising the strong and weak points of securities and more skilful in putting together proposals for the exchange of securities owned for other securities which offer the investor some advantage of price, term, yield or other feature. A substantial volume of business developed in the movement of Canadian securities between Canada and foreign countries as exchange rates and interest rates changed. Taxes began their climb and taxation considerations offered dealers

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a new area where they could serve their clients and develop new business.

13. Paralleling this growth in dealer "know-how" came increasing discrimination on the part of investors -- especially institutional investors who were coping with securities which had failed to perform as anticipated. This climate of difficult markets, more selective buyers, lower volume of business and strenuous competition between investment dealers was in marked contrast to the buoyant, relatively unsophisticated 1920's when the dealer was principally concerned with underwriting and distributing new issues and, in view of the unbroken debt record of borrowers, had no reason based on experience to build into security issues an "extra" margin of safety against depressed economic conditions.

14. In retrospect, it can be seen that the 1930's provided investment dealers, issuers and investors with unforgettable lessons in the hard school of experience -- lessons which were later reflected in improved municipal financing standards and generally better-designed municipal and corporate new issues.

15. During the years 1940-45 activity in the securities business centred in the work of the National War Finance Committee. Once again the Federal Government called on dealer personnel to serve on national and regional committees to spearhead the sales organizations which blanketed the country. The magnitude of this effort is indicated by the results: in two War Loans and nine Victory Loans over 23 million subscriptions were

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secured totalling some $13.1 billions.

16. The investment industry began the post-war period with the conviction, based on the number of Canadians who had purchased Victory Bonds, that it was feasible to build a much larger securities business. During 1945-46 industry leaders, through the agency of The Investment Dealers' Association of Canada, initiated a long-range programme of action designed to raise minimum capital requirements of Member firms, ensure the maintenance of the highest ethical standards, develop employee training facilities and provide investment courses for the general public. The results of this major effort on which was expended thousands of man-hours, are given in part 2 of Appendix A.

17. The growth of the investment business in the post-war period exceeded all expectations. One example: in 1915 three dealers underwrote and sold over a period of some weeks $1 million of Province of Ontario, 10-year 5's which were free of all provincial taxes, including succession duties. In 1955 a group of some 30 dealers and banks underwrote and distributed widely in one day $100 million of Ontario Hydro 22-year 5's at par despite the prevailing high level of taxation on income.

The following table gives some idea of the volume of public new issues of bonds since 1946:

New Issues
(millions of dollars)

	1946	1951	1956	1961
Federal	4,863	4,059	7,777	9,372
Provincial	115	379	557	998
Municipal	129	218	318	443
Corporate	584	453	860	568

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The increase in volume, however, has been accompanied by some new patterns due, among other factors, to the following influences:

18. At the end of the War investors and financial intermediaries were large holders of Government of Canada Bonds. When it became apparent that expansion rather than recession lay ahead, selling of Canada obligations began as the need for liquidity increased and the investment business entered upon a period -- still with us today -- of complex problems surrounding the buying and marketing of Canada Bonds. These problems involve, in addition to the management of the national debt by the authorities, the use of the bond market in the implementation of monetary policies, the use of Federal deficit financing when slack exists in the economy and a decreasing investor appetite for long-term Government of Canada obligations. Demand-supply factors are no longer the chief consideration of the dealer in Canada obligations.

19. From 1950 to 1960 an up-swing took place in investor demand for equities. This demand, which was accentuated by the 20 per cent tax credit, stemmed from two conflicting motivations -- a desire to share in Canada's economic growth and also to acquire a hedge against further decline in the purchasing power of our dollar. An increasing proportion of the dealer's earnings derived from stock business. New issues of corporate bonds and debentures were made more saleable by attaching to them a call on common stock in the form of a conversion privilege or a warrant. This trend has

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been accompanied by a growing investor preference for fixed income securities which offer protection against market fluctuations, e.g., Canada Savings Bonds and the Parity Bonds issued by certain provinces.

20. By 1945 Bank of Canada had become the dominant factor in the high grade bond market, both from the standpoint of holdings of Canada bonds and of trading activity. This made it imperative that the dealers should understand central bank policy. Sometimes this was difficult.

21. Since the introduction of the money market in June, 1954, investment dealers have generated a large volume of trading in short term securities and have shown corporation treasurers, municipal officials and other holders of short-term balances how to use these funds more effectively. Today a varying, but substantial, proportion of the industry's inventory is financed outside the banking system.

22. Increased financial capacity and the employment of more specially trained staff have enabled dealer organizations to underwrite and distribute much larger issues than in the pre-war period in spite of keener competition which has narrowed profit margins both in the primary and secondary markets. Costs of doing business rose steadily during the 1950's and it has become more difficult to carry on a retail business at a profit.

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25. The history of the investment business to date, covering periods of war and peace, prosperity and recession, demonstrates its capacity to adapt itself to varying conditions, including changing investor preferences and fluctuating demands for capital.

THE INVESTMENT BUSINESS TODAY

26. Although influenced by practices and institutions in the older London and New York markets, the investment business in Canada is the result of a gradual evolution to meet conditions in our own economy. Here is a brief description of the business as it is carried on today:

Member Firms and Personnel

27. As at December 31, 1961, the Investment Dealers' Association of Canada had 189 Members, employing 9,329 persons including shareholders and directors (See Exhibit A). (The Membership as this is written -- April 1st, 1962 -- stands at 190). A similar survey taken in August 1958 showed 196 Member firms, employing 8,589 persons (see Exhibit B). These two surveys reveal a reduction in Membership of 7 and an

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increase in the number of personnel employed of some 8 per cent.

28. The number of office workers required to support one salesman or trader has been rising due to the employment of more specialists, such as analysts, engineers, etc., and the increased paper work involved in producing the growing number of reports required for governments and for management. Most of the young men being recruited for sales, underwriting, trading, and research work are university trained. "A CAREER IN FINANCE" issued by the Association in May, 1962, outlines the approach to in-service training of employees used by many firms. A copy of this booklet is attached hereto.

29. Membership in the Association has fallen from its peak of 206 in 1955 to its present (April 1962) level of 190. During this period 47 members resigned and 31 new members were accepted. Reasons for resignation are given in Exhibit C.

30. Exhibit A shows that in December 1961, 110 Members had staff of less than 25 and the 1958 Survey suggests that over 60 of these employ 10 persons or less. In this size of business a few senior partners possess the capital, the clientele and the expertise which makes the business possible. This type of enterprise has a very "personal" quality and is more likely than the larger dealer to encounter problems of continuity of management, including the training and retention of able young men to carry on the business.

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character of the investment dealing business and the substantial proportion (14.5%) of personnel who are partners or shareholders of Member firms or corporations. The Association has deliberately kept its minimum capital requirement ($25,000) low to encourage applications from small investment houses which can meet our standards as to type of business, character and competence. The owners of investment houses are active in the business and there is no absentee ownership except for eleven firms controlled in the United States and most of the latter have one or more resident directors in charge of Canadian operations.

32. While the investment business is concentrated in the metropolitan areas of Toronto and Montreal, it is well-diversified geographically as revealed by the following table:

Area Served	Number of Members	
1 Province	144	
2 Provinces	25	
3 "	4	
4 "	4	
5 "	4	
6 "	3	
7 "	3	
9 "	2	189
Number of Members with foreign head offices		10
Number of Members with branches abroad		30

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The Internal Organization of an Investment House

33. The organization chart given in Exhibit D provides some idea of the internal set-up of the larger investment house. The officers and directors of a typical house of this size include a Chairman, President, 3 - 6 Vice-Presidents (one of whom may be Executive Vice-President) and from 9 - 12 other Directors. Most of these Directors are located in the head office, but some may be in charge of principal branches in other parts of Canada and abroad. Incorporation as a private company is usual with the holding of shares being limited to officers, directors and employees. The total number of shareholders is less than 50 with principal shareholders (5 per cent or over) somewhere in the region of 6 - 10, all of whom will be officers or senior directors. Retirement in the larger houses is usually mandatory at 65 and the retirement of principal shareholders is effected by gradual disposal of their shares starting when the shareholder reaches a stipulated age and continuing until retirement age, by which time the shareholder will have disposed of his entire holding.

34. Since the large investment house has few officers compared to its opposite number in banking and insurance, lines of authority are relatively flexible and frequently a director will fulfill more than one responsibilty, e.g., Vice-President in charge of Sales and Syndicating. As a result of the need for flexibility, there is a wide diversity of practice in the allocation of duties among senior officials and lines of responsibility are frequently blurred. Large

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investment houses are very individualistic in the way in which management functions are divided, e.g., in some firms the Chairman of the Board plays a dominant role in the management of the firm, in others the post is a recognition of distinguished service and the Chairman is regarded as an elder statesman and counsellor. As we move from the larger investment firm to the medium size and smaller firm we find the senior officials in closer contact with the overall operation of the firm. Thus you may find in the small house that the Secretary-Treasurer is also a Director and his principal occupation may be sales. In the small firm the senior officials are responsible both for policy and direction and active in the day-to-day operation of all phases of the business.

35. Policy establishment and decision making rest with the Chairman....President....Vice-President group, i.e., the senior partners. Underwriting negotiations are usually handled by one of this group and when the informal agreement has been signed other specialists take over. Inventory is the responsibility of a Vice-President usually with limits below which he need not consult his partners. The formulation of investment recommendations to clients is often delegated to a specialist who has ready access to senior officers or may report to a special committee of the Board. Employment of trainees for sales, underwriting, trading and research is typically the care of a senior officer concerned with sales. These observations also hold for the medium size and small house except, as noted earlier, the senior officer in the smaller house is likely to be

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concerned with all phases of management.

36. Since the investment dealer handles daily cheques and frequently-negotiable securities running into large sums, the industry has developed, over the years, routines of control and checking to protect these assets from loss, theft or conversion. The Association requires Member firms to carry certain minimum fidelity insurance coverage and the firm must segregate and earmark clients' free securities. Each Member firm is required to select its auditor from a panel approved by the Association's District Auditor. Association By-laws set forth the requirements for the submission of financial statements to the Association's Auditors and any Member which gives concern to the District Auditors are immediately reported to a confidential Audit Committee which has the power to take swift and effective action in correcting the situation. Some larger houses also maintain internal audit facilities which supplement those of the Association. All Member firms select staff carefully and endeavour to the best of the facilities at their disposal to train staff to carry out their duties in an honest and competent manner.

Types of Houses

37. The term "investment dealer" embraces a variety of types of securities business, reflecting in turn the many types of clientele which must be served. It is not possible to list under definite headings the various classifications of dealers as there is always an overlapping as well as a variation in the business transacted by various types. However, in general terms

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investment dealers may be divided into three groups:

The Integrated Houses which originate, underwrite and distribute government and corporate securities; manage banking and selling groups and participate in other dealers' banking and selling groups; maintain underwriting, sales, trading, portfolio management, statistical, research, accounting and delivery departments and carry on a stock brokerage business or operate an affiliate brokerage firm which is a Member of one or more stock exchanges. Integrated investment houses may be national in scope or operate within a province.

Distributing Houses which do not customarily originate industrial issues, but may purchase municipal issues for distribution on their own account; occasionally may be members of a banking group and typically participate in selling groups; vary from small operations with a staff of four or five persons to larger firms with substantially the same facilities, aside from underwriting, as the integrated investment houses.

Specialty Houses: in this category are included those firms which concentrate on a particular phase of the investment

business. Examples: dealers who specialize in trading in outstanding bond issues; dealers who restrict their trading to stocks which are not listed on the stock exchange; dealers who specialize in municipal, school and religious issues; dealers whose principal business is that of a stock-broker, but do operate a bond department including the services of a bond trader.

Principal Functions

38. The work of the investment dealer can be described under three headings: (1) underwriting and primary distribution; (2) trading and secondary markets; (3) informational, advisory and investment management services.

Underwriting

39. The problem before a would-be issuer of securities whether a government or a corporation is how and on what terms can the capital be obtained. Since there are always a number of approaches to a financing problem one of the principal functions of the dealer is to outline the alternatives and recommend what he considers to be the best one in the current circumstances.

40. The principal types of financing involving the use of the services of an investment dealer are:

(a) The purchase of all or part of an issue at public tender -- frequently used with provincial and municipal securities. The dealer estimates

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the yield at which the issue can be sold, adds his anticipated gross profit and calculates his bid.

(b) A negotiated, underwritten public offering where the issuer and dealer arrive by mutual agreement at the type and terms of the security to be purchased by the dealer and sold to the public.

(c) A negotiated, underwritten stock offering confined to shareholders with the dealer agreeing to purchase any of the new securities not taken up by the shareholders.

(d) An "option" offering of an issue by a dealer who acts as an agent.

(e) A "private placement" where the investment dealer acts as the agent of the issuer and negotiates the sale to one or a few buyers, usually investing institutions.

41. Whichever method is used, the dealer is frequently called upon to accept two responsibilities: obtain the funds on terms suitable for the issuer and competitive with other issues in the market and, also, ensure that the security is of sufficiently high quality to warrant its offering to his clients.

Government of Canada Market Issues

42. When a new loan has been approved by the Federal Government, the responsibility for effecting the

[illegible]

[illegible]

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(d) An "option" offering of an issue by a dealer who acts as an agent.

(e) A "private placement" where the investment dealer acts as the agent of the issuer and negotiates the sale to one or a few buyers, usually investing institutions.

11. Whichever method is used, the dealer is frequently called upon to accept two responsibilities: obtain the funds on terms suitable for the issuer and [illegible] to warrant its offering to his clients.

Development of Canada Market Issues

12. When a new loan has been approved by the [illegible]

actual distribution is assumed by Bank of Canada. Over the years the Bank has evolved more or less standard procedures for bringing Government of Canada direct and guaranteed loans to the market. These procedures are subject to variation as market conditions change and as new techniques are tested and do not apply to the sale of Treasury Bills or special offerings such as the 1958 Conversion Loan. The Bank maintains a list of investment dealers and banks which are eligible to take part in the primary distribution of new Canada issues. This list is, in effect, a large selling group. Since 1961 the financial community has been given a few days' advance notice of the Government's intention to come to market on a specified date. On the morning of that day each primary distributor receives an "offering wire" from Bank of Canada informing him of the details of the loan, including the amount offered, price, coupon, yield, term, method of offering, commission, deliveries, payment, sub-agents and reports to be made to the Bank and so on. Investment dealers immediately get to work on the new issue and despatch subscription telegrams to the Bank as soon as a decision can be taken. In some issues the Bank offers each primary distributor a firm allotment which is usually accepted in full. Primary distributors are also permitted to apply for additional bonds, sometimes without limit and sometimes to a maximum which is related to the original allotment. On other issues primary distributors must apply for bonds, calculating how well the loan will be received before entering their application by wire. Some loans

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are heavily over-subscribed and the primary distributor may only receive a pro-rata allotment of his subscription.

43. On one occasion Bank of Canada, after making allotments of firm bonds, invited primary distirbutors to tender for additional bonds. In recent months the Bank has been effecting exchanges of securities with the Government, which exchanges partake of the nature of an advance refunding. In such cases the Bank announced that it was open for bids or exchange offers for the issue being made available and apparently accepted or rejected bids and offers on the basis of their individual appeal. Another technique used by the Bank recently is the reselling of new issue bonds which have been acquired directly from the Government, a procedure which to some extent resembles a "tap" loan. The Federal Government has made extensive use of short-term issues during the past two years. As a rule two maturities are offered at a specified price less a concession to primary distributors who subscribe in accordance with the extent of their orders and, in due course, receive confirmation of their allotments.

PROVINCIAL NEW ISSUES

44. New issues of provincial governments are generally sold by private negotiation or by tender. For smaller issues tenders are sometimes invited from two or more syndicates of investment dealers. In 1961, for example, three groups of dealers tendered for a $7.5 million, Province of New Brunswick issue. Large provincial borrowings, in order to obtain the best results from an orderly marketing, are often sold through

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negotiation to a large syndicate of dealers. Over a long period the Ontario Government and the Hydro Electric Power Commission of Ontario have used this method of marketing. More recently the Provinces of Quebec, Manitoba and Saskatchewan have adopted this procedure of negotiating with large syndicates in order to achieve market stability for their issues.

45. Provincial requirements for borrowed funds have increased to the point where some provinces have been casting about for new methods of raising capital. A recent innovation has been the issuance by the Provinces of British Columbia, Saskatchewan and Manitoba of Parity Bonds, either direct obligations or guaranteed, cashable at par and accrued interest at specified times each year. A substantial proportion of these bonds were sold by investment dealers on an agency basis and over $300 million have been raised through this method of marketing. Five provinces are issuers of short-term securities which are "rolled over" as they mature.

46. The syndicate which buys the issue is known as the "purchase group". Occasionally the purchase group will invite other dealers to join, at a step-up, in the formation of a banking group to share the liability and in larger issues a selling group is usually formed.

MUNICIPAL NEW ISSUES

47. Most new issues of municipal debentures because of their generally smaller dollar size as compared with provincial issues are sold through sealed bids although many large issues and some smaller ones

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<u>MUNICIPAL NEW ISSUES</u>

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are sold by private negotiation. The cities of Ottawa and Regina, for instance, after using both methods, currently favour the negotiated sale as the more effective for a city which faces a heavy borrowing programme and thus a recurring need to come to market. A syndicate of dealers which knows in advance that it will have more of that municipality's debentures to sell maintains a continuing interest in the outstanding securities of the municipality and can prepare a good reception for each new issue.

48. The procedure for selling new municipal debentures by the auction method is more or less standard in all provinces. After the necessary legal requirements have been met, a call for tenders is advertised in the Provincial Gazette and/or the daily press in financial centres and a selected list of dealers is circularized. Syndicate managers advise their partners of the forthcoming issue. A meeting is held at which the municipality's statistical record is studied and a representative of the syndicate may visit the municipality for firsthand talks with civic officials and a personal inspection of the community. The saleability of the new debentures is appraised and a bid mutually agreed upon. The bid contemplates a profit to the syndicate adequate to provide for expenses and a risk factor but at the same time the bid has to be pitched high enough to make it competitive.

49. After the bids are open, and without reference to the issuer, the winning syndicate promptly decides among themselves the method of sale and the

amount of any concessions or allowances and the formal offering of the securities is made to institutional and other investors. The syndicate may consider it unlikely that they will be able to dispose of the whole of the issue as quickly as desirable or may wish wider geographical distribution than obtainable from syndicate members and decide to form a selling group. The size and make-up of the selling group vary with the issue. In joining a selling group a dealer agrees to abide by the conditions of the offering and can request securities at a discount from the public offering price, and he also agrees to maintain the public offering price set by the syndicate until the issue is sold or until released from the agreement by the manager and to report daily to the manager any unsold balances. Attached to the selling group letter is a list of investing institutions which are "exempt" from the general offering by selling group members. These exempt institutions are contacted by the syndicate members in a manner to avoid duplication of coverage and profits from sales to exempt institutions are for the account of the syndicate and confirmed by the syndicate manager. Where an issue is over-subscribed, the books are promptly closed, allotments made on orders received and confirmations sent out to buyers.

50. The liability of each selling group member is limited to the amount of the new issue which he has requested to purchase. Syndicate members operate on a larger spread but must pay syndicate expenses which include concessions to selling group members, legal expenses, cost of printing circulars, etc. and since they

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own the debentures are exposed to risk of loss while distribution is underway.

MONEY MARKET NEW ISSUES

51. Money market securities include Government of Canada treasury bills, Government of Canada bonds and guaranteed bonds with an unexpired term of three years or less to maturity (or to the earliest call date, where a transaction is completed at a premium). Provincial government treasury bills, treasury bills issued by several large municipalities, finance company paper and prime commercial paper are generally classed as being in the money market but are not acceptable for rediscount purposes at the central bank nor eligible for day-to-day loans at the chartered banks.

52. Fourteen investment dealers, active in the money market, and the chartered banks, tender each Thursday for Government of Canada treasury bills. Normally some of these bills are bought against orders and the balance offered to investors and the chartered banks. Provincial and municipal treasury bills and short term coupon notes are purchased both at tender and by negotiation and are sold to investors who have temporary surplus idle cash. In the purchase of prime commercial paper the dealer usually acts as an agent receiving a nominal commission. Transactions in the money market are characterized by large size and a very small margin of profit.

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house and the company. An historical relationship grows up between the dealer and the company, with the dealer having first refusal of any new financing. Among the advantages to a company of such a fiscal agency is the continuing interest of the dealer in the company's financial affairs, continued sponsorship of its securities in the market and the reduction to a minimum of the number of persons with access to company confidential information.

54. The underwriter preparing an issue for a corporation which is coming to market for the first time, makes a thorough investigation of its financial condition, calibre and continuity of management and future prospects, employing for this purpose such experts as engineers, accountants and management consultants. Negotiations, not infrequently run on for months before the decision is taken to "come to the market". This trend to a more thorough appraisal is due to the accumulating experience of the underwriting house and is re-enforced by the requirements of professional investors and "full disclosure" securities acts. During the post-war period our underwriting houses have faced and successfully solved many intricate problems of corporation finance. The pool of skill which exists among Canadian underwriting houses is now very considerable and compares favourably with that in the United Kingdom and United States.

55. In going to the public market a corporation has a great number of vehicles available to it, including common and preferred shares, bonds, debentures, convertible securities, securities bearing warrants, a

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variety of types of sinking funds, serial bonds and term and coupon arrangements, plus a wide range of covenants. The instrument created must be given careful consideration in relation to the capital structure of the company and the current preferences of the market. It is within this milieu of alternative choices that the investment dealer demonstrates his skill and resourcefulness.

56. Once the decision to underwrite is made the representatives of the underwriter and the officers of the issuing corporation prepare and sign an informal agreement covering the significant features of the issue.

57. The question of the offering price and the underwriting compensation are not finally decided until just before the offering. The syndicate manager must correlate all known factors in arriving at a decision, carefully sounding out the probable reception for the issue through talking with his own sales organization and with his banking group asociates. He then presents to the financial officers of the issuing corporation his conclusion as to offering price and underwriting compensation. The matter is discussed freely and if no real differences of opinion develop the terms are presented to the Board of Directors and the arrangement approved. The pricing of the securities is vital -- if the manager prices the issue too cheaply he is subject to criticism from the Company when the price rises sharply in the after market. Should he price them too high the banking group will be left with unsold balances on their

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hands and the issuing company will be critical of the poor reception given its securities.

58. When the approval to issue has been given by the Board of Directors, speed becomes a major consideration and the issuer, the underwriter, counsel for the issuer, counsel for the underwriter, the issuer's auditors, the selected trust company, the printer of the prospectus and the bank note company work together with the goal in mind of producing the following documents: the prospectus, the purchase agreement, syndicate letters, the trust deed or indenture and the debenture certificate.

59. When the prospectus has been approved by all concerned, it is signed by the directors of the company and the underwriters and filed with the appropriate government authorities, including the securities commissions of those provinces in which the underwriter intends to distribute the issue. At the same time, the underwriter is drafting the purchase agreement and, if there is to be a banking group, inviting other houses to join the syndicate. The principal factors governing the selection of dealers to be invited to join the banking group are the issuing company's preference, if any; distributing ability; geographical location of offices; reciprocal business. The banking group agreement which is signed by all participants states the terms, including the price at which the securities are to be sold, under which the distribution is to be effected. Where the syndicate manager deems it advisable a selling group is formed.

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are in force the manager may move securities from dealers who are experiencing a slow sale to those who need more to fill orders. The duration of syndicate restrictions in the past few years became shorter than previously and it is not uncommon to find a syndicate with a life of less than seven days although in a slow moving issue you may find the restrictions in effect from the time of the official offering to delivery date. When distribution of the issue has been completed, the selling and banking groups are terminated and each firm's share of the profits after expenses is allotted pro rata.

61. Despite the best efforts of banking and selling group dealers to place securities with investors who will hold them, a certain amount of selling always occurs before delivery date. Some of this stems from speculators who had hoped to make a quick "turn" and some from investors who intended to buy and hold, but due to unforeseen circumstances must sell. To take care of this inevitable selling the syndicate manager may "go short" by an amount which he judges will mop up the return flow of securities. The size of the short position is a fine calculation to be made by an experienced syndicate manager since an excessive short position can lead to serious losses. When the issue is completely distributed, all dealers who participated in the distribution, and especially the syndicate manager, stand ready to provide a secondary market in the issue.

62. Syndicate Managers accept responsibility for the continuing "good health" of securities which they have helped create and distribute. Should a company which has

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sold its securities to the public through investment dealers develop financial difficulties, the underwriting house will work with the company to solve the problem.

TRADING AND SECONDARY MARKETS

63. The second major function performed by the investment dealer is trading in the secondary market and the maintenance of an inventory of securities which makes it possible to conduct an orderly market. The two principal functions of the secondary market are: (a) to bring buyers and sellers together and (b) to smooth the course of the market by offsetting temporary variations in the demand for and the supply of securities.

64. Secondary market transactions make possible the change in ownership of securities, thus facilitating primary distribution, and establish value levels for outstanding securities. The secondary market consists of two segments: (a) the organized stock exchanges and (b) the street (also called over-the-counter, between-dealer or unlisted) market. The street market includes all fixed income securities and stocks not listed on stock exchanges. At times, and under certain circumstances, shares listed on a stock exchange may trade between dealers who are not members of the exchange.

65. Here is how the street market operates. Prices on the street market are generally determined by negotiation between buyers and sellers although where there is a series of bids or offers made in the process of reaching agreement there is a degree of auction present. There are approximately 200 dealers and a much smaller number of banks and trust companies active in the

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street market, which is principally located in Toronto and Montreal. Dealers active in this market have up to 60 direct lines to other dealers, and to an occasional bank, trust company or large institutional client. It is this network of dealers and institutions connected by telephone, teletype and telex which constitutes the market.

66. Trading in the street market is carried on by "traders". In the larger investment house the work is divided among several traders with one handling money market issues, another long Canada's and provincials, another corporates and so on.

67. The sales and trading departments are closely related, with the salesmen asking for quotations for securities which clients wish to buy or sell and traders providing salesmen with this information as well as quotations on securities owned by the firm or available on the street.

68. Speed is an important factor in a successful trading operation and salesmen and traders are positioned close together so that they can intercommunicate quickly. This process is sometimes assisted by a quotation board which immediately reflects all price changes.

69. The Bank of Canada is a major factor in the "street" market and traders in Toronto and Montreal keep in close touch with Bank of Canada representatives in these cities. The Bank does not call a market but "responds" only to firm bids and offerings, hence dealers are continually phoning the bank to test the market by

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offering or bidding for blocks of Canada bonds.

70. Market information on price, volume, bids and offers is obtained mostly by word-of-mouth by traders talking to each other, but printed information is also provided by some 25 dealers who issue daily, weekly or monthly quotation sheets, and by the bond quotations which are disseminated by the Association to some twenty dailies and two financial weeklies. The Association's quotes, since they are national, are slightly wider than most dealer markets in retail size.

71. In order to have an effective secondary market there must be a number of dealers who are prepared to take securities into position. A security acquired and held is part of the firm's long position. Inventory may be acquired as a result of a slow-moving new issue which will be gradually disposed of over a period of time, as the result of a conviction that a security represents good value and is a desirable merchandise to offer for sale to clients or as a service to clients who wish to dispose of securities. Size of the inventory carried is directly related to the dealer's capital because of the Association's minimum capital regulations which require the margining of inventory held and also because of the need of the dealer to maintain reserves for possible future commitments. A "short position" arises when a dealer sells a security before he owns it. This may occur in anticipation of price declines, in connection with a new issue as previously described, or because the firm is an active trading house striving to give quick service to a client who wishes to buy.

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73. The Investment Dealers' Association assumes responsibility for the supervision of the street market, assisted by the Bond Traders Associations of Toronto and Montreal who provide what day-to-day overseeing is required. Trading Regulations (see Exhibit F) cover such points as good delivery, regular delivery, accrued interest, buy-ins and control of employee trading.

OTHER INVESTMENT DEALER FUNCTIONS

74. Investment dealers provide services ancillary to their principal function of dealing in securities. These include provision of factual information regarding securities and security issuers, advice on investment problems and investment management services.

75. Dealers provide their clients and prospective clients with a continuous flow of information concerning securities, including lists of offerings, market commentaries, quotations, dividends, taxes and called bonds.

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73. The Investment Dealers' Association assumes responsibility for the supervision of the street market, assisted by the Bond Traders Associations of Toronto and Montreal who provide what day-to-day overseeing is [illegible] such points as good delivery, regular delivery, accrued interest, buy-ins and control of employee trading.

[illegible]

7[illegible]. Investment dealers provide services ancillary to their principal function of dealing in securities. These include provision of factual information regarding securities and security issuers, advice on investment problems and investment management [illegible].

75. Dealers provide their clients and prospective clients with a continuous flow of information concerning securities, including lists of offerings, market commentaries, quotations, dividends, taxes and [illegible]

76. On request investment dealers also provide advice on specific investment matters including the review of lists of securities and the making of specific recommendations to buy, sell or hold. The quality of this service is related to the firm's research and statistical facilities. 78 of 177 Members reporting state that they maintain a statistical and research department staffed by at least one full-time specialist. 127 Members of 177 reporting advise that they provide portfolio management services to clients. Typically, these are not discretionary accounts, the client being consulted prior to each change in the portfolio. Some dealers impose an annual fee of 1/2 - 3/4 per cent of the value of the portfolio, which fee may be reduced by the total of profits and commissions arising from transactions effected for the account. Usually, however, no charge is made for this service, the dealer's compensation deriving from profits and commissions on transactions made for the client. At least 14 dealers operate investment companies, chiefly invested in equities, whose shares are offered to the general public. Some four dealers maintain pooled funds, participations in which are available only to clients of the dealer concerned. These pooled funds are designed to offer small clients the advantages of diversification and professional management in the same fashion as a mutual fund.

77. Senior dealer personnel are from time to time called upon to give expert testimony at rate hearings and valuation cases and frequently serve on boards of

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77. Senior dealer personnel are from time to time called upon to give expert [illegible] and valuation cases and frequently serve on boards of

companies whose securities their firms have distributed.

CONCLUSION

78. The investment business because of its complex character, its need to adapt continuously to changing conditions, its confidential nature, the essentiality of high ethical standards and the substantial sums involved even in run-of-the-mill transactions is a profession as well as a business. It is characterized by narrow gross profit margins and the necessity for developing volume if a house is to grow. In contrast with the financial institutions with which they have common boundaries, investment dealer organizations are small and characterized by a high degree of independence and individuality, in which pattern the views and convictions of senior dealers are predominant.

79. Investment dealers -- individually and through their Association -- have made a consistent effort during the post-war period (tempered always by the need and desire to consult in a democratic manner with nearly 200 Member firms and corporations) to raise standards of financial capacity, competence and ethical practice. Mr. J.E. Coyne, then Governor of Bank of Canada, in a public address made on December 14, 1959, stated:

> "....we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, local authorities and business corporations. This is primarily the field of activity of

[illegible]es whose securities their firms have distributed.

[illegible]

78. The investment business because of its complex character, its need to adapt continuously to changing conditions, its confidential nature, the essentiality of high ethical standards and the substantial sums involved even in run-of-the-mill transactions is a profession as well as a business. It is characterized by narrow gross profit margins and the necessity for developing volume if a house is to grow. In contrast with the financial institutions with which they have common boundaries, investment dealer organizations are [illegible] and individuality, in which pattern the views and [illegible]

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> "....we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, [illegible] business corporations. This is [illegible]

investment dealers. I think there is little doubt that the financial machinery existing in Canada for the placing of new issues of securities on the market is the equal of that of any country in the world and, in proportion to our size, it probably arranges, year in and year out, for the provision of a greater quantity of new capital to those requiring it than is the case in any other country in the world. The results achieved are a reflection of the industry and enterprise and broad national outlook of our investment dealers...."

- End -

PART 1 - EXHIBIT "A"

PERSONNEL DATA

Notes: (1) This summary shows the total number of full-time staff employed by Members as at December 31, 1961.
(2) Members incorporated in, or with principal office in Canada, included entire staff, Members incorporated, or with principal office outside of Canada, included only staff employed in Canada.
(3) Summary includes only personnel engaged in the securities business.

	Range						Total	
	1 - 24		25 - 99		100 and Over			
	No.	%	No.	%	No.	%	No.	%
Salesmen and Saleswomen	346	28.1	613	25.1	1,309	23.1	2,268	24.3
Sales Trainees	12	0.9	47	1.9	134	2.4	193	2.1
Trading:								
Bond Traders	54	4.4	77	3.2	148	2.6	279	3.0
Stock Traders	53	4.3	125	5.1	190	3.4	368	3.9
Other trading personnel	36	2.9	165	6.8	396	7.0	597	6.4
Underwriters	8	0.6	27	1.1	65	1.1	100	1.1
Analysis and Statisticians	12	1.0	67	2.7	105	1.9	184	2.0
Other specialists	1	0.1	9	0.4	30	0.5	40	0.4
Senior Administrative	227	18.5	252	10.3	340	6.0	819	8.8
Accounting and Delivery Personnel	249	20.3	509	20.8	1,549	27.4	2,307	24.7
All others	232	18.9	552	22.6	1,390	24.6	2,174	23.3
Total Personnel	1,230	100.0%	2,443	100.0%	5,656	100.0%	9,329	100.0%
Number of the above total who are shareholders (if a limited company or partners (if a partnership)	365	29.7%	426	17.4%	562	9.9%	1,353	14.5%
Number of Members reporting	110		52		24		186	

PERSONNEL DATA

Notes: (1) This summary shows the total number of full-time staff employed by Members as at December 31, [illegible]
(2) [illegible]
[illegible]
(3) Summary includes only personnel engaged in the securities business.

PART 1 - EXHIBIT "A"

	Range 1 - 24 No.	%	25 - 99 No.	%	100 and Over No.	%	Total No.	%
Salesmen and Salesmen	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Sales Trainees	12	0.9	47	1.9	134	2.4	193	2.1
Trading:								
Bond Traders	54	4.4	77	3.2	148	2.6	279	3.0
Stock Traders	53	[illegible]	125	5.1	190	[illegible]	368	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Other specialists	1	0.1	9	0.4	30	0.5	40	0.4
Senior Administrative	227	18.5	252	10.3	340	6.0	819	8.8
Accounting and Delivery Personnel	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
All others	232	18.9	552	22.6	1,390	24.6	2,174	23.3
Total Personnel	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Number of the above total who are shareholders (if a limited company or partners (if a partnership)	365	29.7%	426	17.4%	562	9.9%	1,353	14.5%
Number of Members reporting	110		52		24		186	

IDAC - PERSONNEL SURVEY - AUGUST 29, 1958

TABLE "A"

	No. of Staff 1-10	%	No. of Staff 11 - 25	%	No. of Staff 26 - 50	%	No. of Staff 51 - 100	%	No. of Staff 100 - 200	%	No. of Staff Over 200	%	Totals	%
Number of firms in Group	66		56		30		26		9		9		196	
Shareholders and Partners	167	41.3	244	25.4	201	19.0	218	12.8	153	10.9	280	9.1	1,263	14.7
All other staff	237	58.7	715	74.6	853	81.0	1,490	87.2	1,254	89.1	2,777	90.9	7,326	85.3
Totals	404	100%	959	100%	1,054	100%	1,708	100%	1,407	100%	3,057	100%	8,589	100%

Note: 193 Member Firms responded
1 Member Firm did not respond
2 Member Firms filed combined returns for their investment firm and stock affiliate.

PART I - EXHIBIT "B"

TABLE "B"

	No. of Staff 1 - 10	%	No. of Staff 11 - 25	%	No. of Staff 26 - 50	%	No. of Staff 51 - 100	%	No. of Staff 101 - 200	%	No. of Staff Over 200	%	Totals	%
Number of Firms in Group	66		56		30		26		9		9		196	
Salesmen	100	24.8	264	27.5	274	26.0	378	22.1	343	24.4	634	20.7	1,993	23.2
Saleswomen	3	.7	6	.6	6	.6	2	.1	8	.6	5	.2	30	.3
Sales Trainees	1	.2	12	1.3	19	1.8	31	1.8	32	2.3	62	2.0	157	1.8
Bond and Unlisted Stock Traders	24	5.9	48	5.0	46	4.4	76	4.4	45	3.2	99	3.2	338	3.9
Floor Traders	-	-	52	5.4	49	4.6	73	4.3	41	2.9	44	1.4	259	3.0
Underwriters	8	2.0	4	.4	20	1.9	14	.8	15	1.1	53	1.7	114	1.3
Analysts and Statisticians	2	.5	17	1.8	33	3.1	36	2.1	30	2.2	61	2.0	179	2.1
Accounting and Delivery Personnel	55	13.6	178	18.6	203	19.3	358	21.0	337	23.9	672	22.0	1,803	21.0
Other Specialists	-	-	2	.2	3	.3	15	.9	12	.9	23	.8	55	.7
Senior Administrative	116	28.7	143	14.9	131	12.4	155	9.1	71	5.0	107	3.5	723	8.4
All others	95	23.6	233	24.3	270	25.6	570	33.4	473	33.5	1,297	42.5	2,938	34.3
Totals	404	100%	959	100%	1,054	100%	1,708	100%	1,407	100%	3,057	100%	8,589	100%

TABLE "B"

	No. of [illegible] 1 - 10		No. of [illegible] 11 - 25		No. of [illegible] 26 - 50		No. of [illegible] 51 - 100		No. of [illegible] 101 - 200		No. of [illegible] Over 200		[illegible]	
Number of Firms in Group	66		55		30		26		9		3		[illegible]	
		%		%		%		%		%		%		%
Salesmen	100	24.8	264	27.5	274	26.0	378	22.1	343	24.4	634	20.7	[illegible]	[illegible]
Saleswomen	3	.7	6	.6	6	.6	2	.1	8	.6	5	.2	[illegible]	[illegible]
Sales Trainees	1	.2	12	1.3	19	1.8	31	1.8	32	2.3	62	2.0	[illegible]	[illegible]
Bond and Unlisted Stock Traders	24	5.9	48	5.0	46	4.4	76	4.4	45	3.2	99	3.2	[illegible]	[illegible]
Floor Traders	-	-	52	5.4	49	4.6	73	4.3	41	2.9	44	1.4	[illegible]	[illegible]
Underwriters	8	2.0	4	.4	20	1.9	14	.8	15	1.1	53	1.7	[illegible]	[illegible]
Analysts and Statisticians	2	.5	17	1.8	33	3.1	36	2.1	30	2.2	61	2.0	[illegible]	[illegible]
Accounting and Delivery Personnel	55	13.6	178	18.6	203	19.3	358	21.0	337	23.9	672	22.0	[illegible]	[illegible]
Other Specialists	-	-	2	.2	3	.3	15	.9	12	.9	23	.8	[illegible]	[illegible]
Senior Administrative	116	28.7	143	14.9	131	12.4	155	9.1	71	5.0	107	3.5	[illegible]	[illegible]
All others	95	23.6	233	24.3	270	25.6	570	33.4	473	33.5	1,297	42.5	[illegible]	[illegible]
Totals	404	100%	959	100%	1,054	100%	1,708	100%	1,407	100%	3,057	100%	8,589	100%

PART I - EXHIBIT "C"

CHANGES IN I.D.A.C. MEMBERSHIP: APRIL, 1955 - MARCH, 1962

	New Members	Resignations
1955 - 1956	4	4
1956 - 1957	1	8
1957 - 1958	8	5
1958 - 1959	1	9
1959 - 1960	7	9
1960 - 1961	7	4
1961 - 1962	3	8
	31	47

Reason for Resignation:

Going out of business (1)	20
Dual members resigning (2)	9
Dual members merging (2)	2
Business sold to another Member	7
Inability to meet I.D.A.C. requirements	5
Resigned and later rejoined	2
Business sold to new interests and character of business changed	2
	47

Notes:

(1) Death or retirement of a senior partner or senior partner or principal contributor of capital was the most common reason for going out of business. In many cases one or more of the partners or directors of the resigning firm eventually become associated with other member firms or corporations.

(2) At one time the Association had a number of "dual" memberships where both the investment dealing organization and the affiliated stock exchange organization held memberships. Changes in the way of doing business resulted in 9 stock exchange houses resigning. In two cases the stock business was merged with the investment business in one company.

1955 - 1956	4	4
1956 - 1957	1	8
1957 - 1958	8	5
1958 - 1959	1	9
1959 - 1960	7	9
1960 - 1961	7	4
1961 - 1962	3	3
	31	47

Reason for Resignation:

Going out of business (1)	20
Dual members resigning (2)	9
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ILLUSTRATIVE ORGANIZATION PLAN FOR THE LARGER

Chairman

President

Vice-President and General Manager

Vice-President Trading	Vice-President Sales	Vice-President Corporation Financing	Vice-President - Govt. & Municipal Financing	Vice-President Stocks	* # Secretary and Treasurer
Bonds	* Ontario Branches	Underwriting	Underwriting	Block Stock	Comptroller
Money Market	* Quebec Branches	Syndicating	Syndicating	Arbitrage	Office-Manager Personnel
Unlisted Stocks	* Western Branches	Business Development	Business Development	Floor Traders	Accounting and Deliveries
	U.S. Sales			Order Dept.	
				Wire Room	

Research

* Portfolio Management

NOTES:

1. (*) indicates function usually in charge of a director. A director may be responsible for more than one function.
2. United States sales and stock business are frequently handled through an affiliated firm or corporation.
3. Some investment houses use an "Executive Committee of the Board. Some houses designate the Senior Vice-President as "Executive Vice-President".
4. Advertising brochures, etc. are usually the responsibility of an official in the sales or underwriting department.
5. (#) At least one Member has a Vice-President, Finance.

PART II

HISTORY

1. The Investment Dealers' Association of Canada was formed in June 1961 under the name Bond Dealers' Association of Canada. It was the result of a merger of a group of bond dealers in Montreal and the financial section of the City of Toronto Board of Trade.

2. The Association originally started with 32 Members, all except one having their Head Office located in either Toronto or Montreal. By 1920 the membership had grown to 104 firms, many with branches located across the country. The Association could be said by that date to have attained National stature. The name Bond Dealers' Association of Canada was felt not to be descriptive of the diverse and expanding business carried on by the Members of the Association. In 1925 the name was changed to The Investment Bankers' Association of Canada and the Members of the Association began to refer to themselves as Investment Bankers, thus following the nomenclature in general use in the United States.

3. In 1934 the Bank Act was changed and one of the amendments was to restrict to Chartered Banks the use of the names Bank or Banker. It was accordingly necessary to search for an alternative name for the Association to describe the type of business carried on by its Members. The term Investment Dealer was decided upon, the name of the Association became the Investment Dealers' Association of Canada and Members were encouraged to refer to themselves as Investment Dealers. The term

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is now widely accepted in Canada and official recognition has been given to it in the Securities Acts of several of the Provinces.

4. By 1939 the Association had a membership of 130 located across Canada and was in a favourable position to co-operate with the Government in the emergency of war. The National War Finance Committee included a large number of Investment Dealers who played a vital role in the financing of Canada's war effort.

5. Since the end of World War II the Association has continued to grow and expand its scope. After reaching a peak of 208 Members in 1958 the membership has now levelled off, owing mainly to mergers and buy-outs, to 189 Members. Although some slight reduction of this number may be expected, the outlook for the foreseeable future is that this approximate membership will be maintained. Exhibit A shows the Members of the Association as at 31st January, 1962.

6. Since its inception, the Association's Head Office has been maintained in Toronto. In 1947 a Branch office was opened in Montreal to serve the needs of the Members in that city and throughout the Province of Quebec. This office has now become an essential part of the Association and has done much to establish and maintain its national character. Recently a French translation of the Association's name has been approved and Members in the Province of Quebec are encouraged to make use of this name as well as the English version.

7. In 1947 an Education Programme was started for the employees of Members and for the general public.

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7. In 1947 an Education Programme was started

Two correspondence courses for employees and a number of courses of various types for the public, are now offered by the Association. Work on a third employee course is at present in progress. In keeping with the National aspect of the Association one of the employees' courses and a number of the courses for the general public are available in French, and all course assignments may be answered in French.

STRUCTURE AND ORGANIZATION

(a) Constitution and By-Laws

8. Membership in the Association is governed by its Constitution and By-laws. The Association is an unincorporated non-profit body. The Constitution and By-laws may from time to time be repealed, amended or re-enacted by the National Executive Committee of the Association, subject always to the approval of the Members passed at a General or special meeting of the Association, by an affirmative vote of two-thirds of the votes given on such Resolution. They encompass the basic philosophy and operations of the Association and allow the making of Regulations pursuant to the by-laws for the day to day operations of the Association and its Members.

9. The right to apply for Membership in the Association is open to all individuals, firms or corporations carrying on business in Canada as Investment Dealers, provided that the business of the applicant is of such character that at least half of the gross profits of such business for the twelve month period immediately prior to application resulted from, or consisted of, the underwriting, distributing or buying and selling,

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either as principal or agent, from and to the public in Canada, of investment securities including bonds, debentures, notes and shares of an investment character. In addition, at least 50 per cent of the principals of all applicants for Membership must have been in the investment business for at least five years, and all applicants must possess a minimum of $25,000 liquid capital plus such extra capital as may be required to allow them to hold inventory, carry margin accounts and carry on other operations necessary to their business.

10. An applicant for Membership in the Association is first screened by the local District Executive Committee, and providing it satisfies the requirements of By-law No. 1 of the Association and is approved by the Committee, notice of the application is given to all Members who have a period of time in which to object to the applicant. If there is no objection, the application is referred to the National Executive Committee for their final decision.

11. During the forty-six years of its existence, the Association's By-laws have been continually amended to reflect the changing standards and requirements of the industry, and there have been periodic reviews of the Membership requirements with particular reference to standards of ethics, type of business transacted and financial position.

12. Exhibit B contains the Constitution and By-laws of the Association, and Exhibit C the Regulations of the Association, except the Trading and Delivery Regulations.

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(b) Organization

13. The Investment Dealers' Association of Canada is a National organization, but in keeping with the size and diversity of Canada it is divided into six Districts, as follows: Atlantic District (Provinces of Newfoundland, New Brunswick, Nova Scotia and Prince Edward Island); Quebec District (Province of Quebec); Ontario District (Province of Ontario); Mid-Western District (Provinces of Manitoba and Saskatchewan); Alberta District (Province of Alberta); and Pacific District (Province of British Columbia). Each district is under the direction of a Chairman and District Executive Committee, the District Chairmen being Vice-Presidents of the Association and comprising, along with the President and Immediate Past President, the National Executive Committee. In addition, each district has a District Business Conduct Committee comprised of the District Chairman, the past five District Chairmen still active in the investment business, and the Managing Director. Appeal lies from this Committee to the National Business Conduct Committee which is made up of the Immediate Past President and the four previous Past Presidents still active in the business. The Association and each District appoints auditors and the Association retains Counsel in Toronto and Montreal.

14. The permanent Executive staff of the Association is made up of a Managing Director, Secretary-Treasurer, Director of Education, Regional Director and Secretary Emeritus.

15. Exhibit D lists the Officers, Committees

Organization

13. The Investment Dealers' Association of Canada is a National organization, but in keeping with the size and diversity of Canada it is divided into six Districts, as follows: Atlantic District (Provinces of Newfoundland, New Brunswick, Nova Scotia and Prince Edward Island); Quebec District (Province of Quebec); Ontario District (Province of Ontario); Mid-Western District (Provinces of Manitoba and Saskatchewan); Alberta District (Province of Alberta); and Pacific District (Province of British Columbia). Each district is under the direction of a Chairman and District Executive Committee, the District Chairmen being Vice-Presidents of the Association and comprising, along with the President and Immediate Past President, the National Executive Committee. In addition, each district has a District Business Conduct Committee comprised of the District Chairman, the past five District Chairmen still active in the investment business, and the Managing Director. Appeal lies from this Committee to the National Business Conduct Committee which is made up of the Immediate Past President and the four previous Past Presidents still active in the business. The Association and each District appoints auditors and the Association retains Counsel in Toronto and Montreal.

14. The permanent Executive staff of the Association is made up of a Managing Director, Secretary-Treasurer, Director of Education, Regional Director and [illegible].

and Auditors of the Association for the year 1961-62 and the Past Presidents of the Association since its inception.

(c) Comparison With United States and United Kingdom Associations

16. The Investment Dealers' Association of Canada is not directly comparable to securities organizations or associations in other countries. Although in their early days the Investment Bankers Association of America and The Investment Dealers' Association of Canada were similar in their function, over the years the two Associations have developed along somewhat divergent lines.

17. Membership in the Investment Bankers Association of America represents only a small percentage of the securities dealers in that country (approximately 15 per cent of the nearly 5,000 securities dealers). In the United States there is Federal Securities Legislation in addition to the Securities Legislation in the various States and membership in the U.S. Federal Government sponsored and controlled National Association of Securities Dealers is compulsory for all securities houses in the country. The Investment Dealers' Association of Canada performs some of the functions of both these Associations. In Canada there is no Federal Securities Legislation other than companies legislation and the Securities Acts under which Investment Dealers operate are provincial statutes. In the Securities Acts of the Provinces of Ontario, Alberta and Saskatchewan, the Association is specifically referred to, and is given

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certain rights and responsibilities thereunder. A number of other Provincial Securities Acts are at present under review, and it seems likely, in at least one other Province, that the Association will be granted similar rights and responsibilities.

18. In the United Kingdom there is no organization or association comparable to The Investment Dealers" Association of Canada. The Issuing Houses Association performs a somewhat similar function in the field of new issue underwritings. There, hoever, any comparison ends. The secondary market in securities owned as principal, is, in the United Kingdom, carried on by jobbers, and these firms come under the control of the London or other Stock Exchange on which they operate.

FUNCTIONS

19. The principal functions of The Investment Dealers' Association of Canada are as follows:

(i) Protection of the Investing Public;
(ii) Mutual Protection of Members;
(iii) Maintenance of High Ethical Standards;
(iv) Maintenance of Orderly Marketing and Trading;
(v) Education of Members' Employees and the Public;
(vi) Provision of Statistical Data;
(vii) Publications;
(viii) Liaison with Other Financial Institutions.

(i) Protection of the Investing Public

20. Investment Dealers are conscious of their responsibilities to the investing public, both to institutions and to the ordinary citizen. They endeavour to maintain highest standards of ethics and reliability,

and to ensure that all members of the public receive expert advice and completely fair treatment. The Association attaches the greatest importance to this.

21. At all times the Association has endeavoured to keep the interests of the nation and the investing public to the forefront. The Association has been outspoken in its attempts to ensure that investors are fairly and equitably treated by Corporations and Governments alike, particularly during financial re-organizations.

22. In particular, the Association controls in its By-laws and Regulations the type of business carried on by its Members or to be carried on by new Members, and the minimum financial requirements of its Members or of new Members.

23. (a) <u>Type of Business</u> - The by-laws require that all Members of the Association and applicants for membership, must derive at least 50 per cent of their profits from the underwriting, distributing, or buying and selling, either as principal or agent, from and to the public in Canada, of investment securities (including bonds, debentures, notes and shares of an investment character) as defined in the By-laws. At the discretion of the applicable District Executive Committee, a Member (or applicant) may submit its dollar volume rather than profits. Applicants who have not been in business in Canada for at least one year may be admitted to membership on an estimate of their proposed business, but are liable to six-monthly reviews on the type of business they conduct for two years after admission to the Association.

All members are liable to periodic routine reviews on the type of business they conduct, and at the discretion of either the National Executive Committee or the applicable District Executive Committee may be required to submit special reviews.

24. The By-Laws define investment securities to include (i) government, municipal, hospital, school, corporations and religious institutions, bonds, debentures, notes and other securities not in default of principal or interest; (ii) preferred shares not in arrears of dividends; (iii) such common shares with demonstrated earning power whether or not dividend paying, such shares in Investment Companies, and such other securities as the applicable District Executive Committee, with the concurrence of the National Executive Committee, may from time to time approve as investment securities.

25. Exhibit E consists of the Application for Membership form and the form used when requiring Members to submit a breakdown of the type of their business.

26. (b) Minimum Financial Requirements - All Members of the Association are required to maintain minimum capital in accordance with the type and magnitude of operations carried on. The minimum liquid capital which is to be maintained must be at least $25,000, but this has to be supplemented, and such liquid capital must be at least sufficient to provide an adjusted liquid capital equal to the sum of

(i) 2% of the Members' current liabilities or $50,000 whichever is less;

(ii) 2% of the Member's adjusted liabilities;

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25. Exhibit 5 consists of the Application for Membership form and the form used when requiring Members to submit a breakdown of the type of their business.

25. (b) <u>Minimum Financial Requirements</u> - All Members of the Association are required to maintain minimum capital in accordance with the type and magnitude of operations carried on. The minimum liquid capital which is to be maintained must be at least $25,000, but this has to be supplemented, and such liquid capital must be at least sufficient to provide an adjusted liquid capital equal to the sum of

(i) 2% of the Members' current liabilities or $50,000 whichever is less;

(ii) [illegible]% of the Member's adjusted liabilities;

(iii) Such additional amount as may be required if a Member does not deposit all clients' free credit balances in a Clients' Trust Account or carries margin accounts for clients or sells securities on an instalment payment plan.

In the case of a large national or international house carrying on a fully diversified Investment Dealers' business, the total amount of minimum capital required would be very substantial. Members are obliged to segregate clients' securities held in safekeeping from their own securities, and to carry minimum insurance coverage.

27. By-law 8A of the Association and the Regulations of the National Executive Committee made pursuant thereto, outline the minimum capital requirements of the Association. By-law 8C and the Regulations of the National Executive Committee made pursuant thereto, contain the insurance requirements of the Association. (Refer to Exhibits B and C).

(ii) Mutual Protection of Members

28. In common with other trade associations, one function of The Investment Dealers' Association of Canada is the protection of its Members. Every effort is made to foster the interests of the Investment Dealer, and the Association, when required, submits briefs and recommendations on behalf of the industry to the appropriate authorities.

(iii) Maintenance of High Ethical Standards

29. The speed at which securities transactions

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(iii) Maintenance of High Ethical Standards

29. The speed at which securities transactions

take place makes it impractical for each sale or purchase to be confirmed in writing at the time. Shares or bonds are bought and sold by word of mouth, either personally or over the telephone, and although confirmed by letter as soon as possible (usually the same day) this confirmation is not received by the other party until the next day at the earliest. However, failure to honour these verbal contracts is extremely rate, and the word of an Investment Dealer is regarded as his bond.

30. Although Members of the Investment Dealers' Association of Canada have built up an enviable record for their ethics, nevertheless infringements of ethics or of the Association's Rules and Regulations do take place. A District Business Conduct Committee is set up in each District to hear and investigate fully any complaints against Members of the Association. Not only is the structure of these committees such that only senior members of the industry serve on them, but in all important matters the opinion of counsel is sought, thus helping to ensure that the Rules and Regulations of the Association are fairly and impartially enforced and that high ethical standards are maintained. There is appeal to the National Business Conduct Committee, which consists of five Past Presidents of the Association.

31. The Association feels, particularly since the amendments to the Disciplinary By-laws in October, 1961, that all complaints against Members have been quickly and fairly dealt with by the appropriate committee or committees. In the past two years two Members of the Association have been suspended and three Members have

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been fined.

(iv) Maintenance of Orderly Marketing and Trading

32. The Investment Dealers' Association of Canada exercises the ultimate responsibility for the manner in which secondary trading in Treasury Bills, bonds, debentures and unlisted shares in Canada is conducted. Day to day control over this trading is exercised respectively in Toronto and Montreal by the Toronto Bond Traders' Association and the Montreal Bond Traders' Association. These two associations are composed of representatives of Investment Dealers, Chartered Banks and certain other financial organizations.

33. Both Bond Traders' Associations are subsidiary to The Investment Dealers' Association of Canada and agree in their By-laws or Regulations to be bound by the decisions of the Association as regards to unlisted trading. In practice, all routine matters are handled by the committees of the two Bond Traders' Associations, whose decisions are normally final. However, any Member of The Investment Dealers' Association of Canada who is dissatisfied with a ruling of one or other of the Bond Traders' Associations is entitled to bring the matter before the District Executive Committee of The Investment Dealers' Association of Canada who, through their Bond Traders' Liaison sub-committee, would investigate the matter. The Bond Traders' Associations make such rules and regulations as they feel necessary and desirable for orderly trading, and although these provisionally go into force when passed, they are referred to The Investment Dealers' Association of Canada for confirmation, and if not

[illegible]

[illegible]

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so confirmed would lapse.

34. Exhibit F contains the Trading and Delivery Regulations of The Investment Dealers' Association of Canada.

35. The Investment Dealers' Association of Canada maintains close liaison and contact with the Government of Canada, the Bank of Canada, and the Provincial Governments and Securities Commissioners. This contact is not only established and maintained by the elected Officers immediately on taking office, but is maintained on a continuing basis by the Managing Director and other permanent Officers of the Association.

(v) Education of Members' Employees and the Public

36. From its inception in 1947, the I.D.A.C. education programme has been rapidly expanded and now covers two distinct areas. A comprehensive internal education programme has beendeveloped to speed the training of new employees within the industry in many of the complexities of the investment business and thereby to equip them to serve the public better. An external education programme has also been developed to acquaint the Canadian investing public with the fundamental terms, procedures and principles of sound investment management. The Association employs a full-time education officer to direct both programmes.

(a) Internal Education

37. The Association's internal education programme is founded on two correspondence courses entitled "Principles and Practices of Investment Finance in Canada." Both courses were written by experts in the

so confirmed would lapse.

34. Exhibit 6 contains the Trading and Delivery Regulations of The Investment Dealers' Association of Canada.

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(d) Internal Education

37. The Association's internal education programme is founded on two correspondence courses entitled "Principles and Practices of Investment Finance

industry and both are revised and have new assignment questions added each year. Course I is designed for all new employees of Member firms, though it is also made available to members of most other financial institutions and to financial employees of Canadian corporations. It covers such topics as elementary accounting, the interpretation of financial statements, the characteristics of various types of investment securities, the origination and trading of securities, I.D.A.C. regulations and the Provincial Securities Acts. Course II is at present restricted to employees of Investment Dealers, members of Canadian stock exchanges and editorial employees of the financial press. This course leads the student into more detailed financial analysis and covers corporate, provincial and municipal underwriting and security distribution; the operations of the Bank of Canada; the money market; portfolio management and salesmanship.

38. The material for these two courses is mailed to students at regular intervals during the year and within a specified time completed assignments must be submitted. These are marked and graded and at the end of each Course there is a compulsory examination. To date, with some 5,996 persons having enrolled in the two courses, a total of 3,601 have successfully completed the programmes. Exhibit G shows the cumulative record of course results.

39. At the time of writing, a third course for Members' employees is being prepared. This course will outline the banking, accounting, contractual, regulatory

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(b) External Education

40. Each year the Association prints and distributes to the general public a revised edition of its Home Study Correspondence Course "How to Invest Your Money in Bonds and Stocks." This course covers such subjects as bonds and debentures, preferred and common shares, the interpretation of financial statements and portfolio management. At present, the course is distributed to the public through the Universities of Western Ontario and Saskatchewan in English, and Laval University in French. It has received wide distribution both in Canada and abroad. A total of some 18,000 persons have enrolled in the English language version and approximately 2,000 in the French edition. Commencing September, 1962 the Association itself intends to take over distribution of the English edition of the course in an attempt to obtain even wider public distribution.

41. The Association maintains across the country active voluntary Speakers' Panels composed of Members' employees. Speeches are given on request to a large number of organizations including universities, schools, service clubs, women's associations, trade and professional bodies. About 100 public addresses have been arranted by the Association during the past year.

42. In 1954 the Association produced a film entitled "A Matter of Importance." It stresses the importance of an investment programme to a typical young Canadian family. This film is available to Members of the Speakers' Panel where it has received over 300

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42. In 1954 the Association produced a film entitled "A Matter of Importance." It stresses the importance of an investment programme to a typical young Canadian family. This film is available to Members of the Speakers Panel where it has received over 200

showings. It has also been widely screened on television across the country.

43. Our public educational programme also includes lecture courses for employees of Canadian companies and evening lecture courses for the general public held in co-operation with a number of Canadian universities, school boards and other educational bodies. Exhibit H shows that over 1,700 Canadians were enrolled in these courses during the past year.

44. In the Spring of the past seven years the Association has co-operated with the Toronto and Montreal Stock Exchanges in week-long visits of staff members of the commerce and finance departments of Canadian universities. This programme has given over 50 Canadian university professors an intimate glimpse of the operationsof Member firms and helped to broaden their understanding of the investment industry's role in the continued growth of our economy.

45. For the past few years several of our larger Members have also played host to visiting high school teachers and guidance counsellors. These visits have helped acquaint the teachers with career opportunities in the investment business for their commercial and business graduates and assisted the industry in recruiting promising junior personnel.

(vi) Provision of Statistical Data

46. Apart from an employee survey completed in 1958 and several surveys conducted in preparation for this Brief, the Association has attempted little in the way of gathering statistical data on the operations of

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46. Apart from an employee survey completed in 1958 and several surveys conducted in preparation for this Brief, the Association has attempted little in the

its Members. This failure has been the result of the formidable problems involved in gathering reliable statistical information. It has become apparent that no two firms within the Association keep their books in the same way. For example: fiscal-year-ends among our Members fall throughout the calendar year; some firms record sales on transaction dates, others on delivery dates; and no two firms have precisely the same business "mix" between the institutional, retail, money market, bond and stock aspects of their business.

47. The Association is hopeful, however, that a full and accurate statistical picture of the industry will soon emerge. A recent request from the Dominion Bureau of Statistics for further factual data as well as similar requests from the present Royal Commission have made many Members aware of the poverty of statistical information presently available and the value it would have for all concerned. The Association's new education course currently under development is also expected to help in standardizing accounting practices within the industry and make regular statistical collection and periodic statistical reviews more readily obtainable.

48. Nevertheless, since 1960 the Association has collected from its Members, through its District Auditors, a total of Members' borrowings outside the banking system and the Bank of Canada by any method on the collateral of securities owned by the Member, including day-to-day, call and term loans, buy-backs and re-purchase agreements where the aggregate total of such borrowing is in excess of $500,000. These totals are

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available to Members on request every Friday morning. They are also released on a confidential basis to the Bank of Canada, the Department of Finance and the Dominion Bureau of Statistics.

49. Similarly, the Association co-operates with the Dominion Bureau of Statistics in obtaining, assembling and distributing statistics showing the sales and purchases of securities between Canada and other countries. These are reproduced and circulated to all Members of the Association. For an example, see Exhibit I.

50. Each business day, the bid and asked quotations on leading corporation, government and overseas bonds are gathered from Member firms and distributed nationally to the financial press. Weekly reports on the domestic bond market are also supplied to Canadian Press and the Canadian Broadcasting Corporation.

(vii) Publications

51. For the convenience of its Members, the Association maintains a Directory of Members brought up-to-date twice yearly. This Directory lists all the Members of the Association with their branches, wire communications, partners, officers and directors. Exhibit J is the Association's Directory of Members.

52. The Association currently issues four other publications for distribution to Members and to the general public. These are as follows:

* "Canada and Canadian Provinces, Funded Debts Outstanding" - This book is published annually with half yearly supplements and at present about

17,000 copies of each are distributed each year.

* "How to Read Financial Statements" - Designed for the novice investor, this publication first appeared in 1958 and over 42,000 copies have now been distributed.

* "Investment Terms and Definitions" - Also for the notice investor, this booklet has been in print, with periodic revisions, for over 15 years. Some 60,000 copies of it have now been distributed.

* "A Career in Finance" - This publication tells the high school and university graduate about career opportunities in the investment industry. It has recently been completely rewritten and 15,000 copies of the new version are now being printed.

Exhibit K contains copies of these four publications.

(viii) <u>Liaison with Other Financial Institutions</u>

53. The Investment Dealers' Association of Canada maintains liaison with the leading Stock Exchanges in the country. Three districts (Quebec, Ontario and Pacific) maintain Stock Exchange Liaison sub-committees and consultation with the local Stock Exchanges takes place on matters concerning the functioning of the financial industry.

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55. Abroad, the Association maintains contact and exchange of information with the Investment Bankers Association of America, and some 32 Members of the Association are also Members of the Investment Bankers Association of America.

Trends and Indications for the Future

56. In the years ahead the Association intends to expand and refine its internal education programme to equip employees of Member firms to serve the public better. Moves towards a broader programme of public education may also be expected. To strengthen the protection given to the investing public, the Association intends to maintain and improve its Members' standard of ethics and type of business by further tightening of existing regulations on membership and discipline. Finally, the Association hopes to embark on a fuller and more regular programme of statistical collection and reporting which should assist our Members, government bodies and other interested parties in understanding the ever-changing nature of our business.

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O F F I C E R S AND C O M M I T T E E S

of

The Investment Dealers' Association
of Canada

Head Office
55 Yonge Street, Toronto

Regional Office
132 St. James Street West, Montreal

OFFICERS 1961-62

President
Arthur J. Milner
Mills, Spence & Co. Limited, Toronto

Vice-Presidents

J. William Ritchie,
Eastern Securities Company Limited
Halifax.

D.J. Langill,
W.C. Pitfield & Company
Limited, Winnipeg

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Nesbitt, Thomson and Company,
Limited, Montreal.

K.M. Johnston,
Wood, Gundy & Company
Limited, Calgary

D.S. Beatty,
Burns Bros. & Denton Limited,
Toronto

Ross Wilson,
A.E. Ames & Co.Limited
Vancouver.

Immediate Past-President

Eric S. Morse,
W.C. Pitfield & Company Limited

Honorary President

C.L. Gundy,
Wood, Gundy & Company
Limited, Toronto.

Honorary Vice-President

J.R. Hughes,
Royal Securities Corporation
Limited, Montreal.

Honorary Treasurer

J. Edgar Hill,
Royal Securities
Corporation Limited,
Montreal.

Managing Director

H.L. Gassard,
The Investment Dealers' Association
of Canada, Toronto

Assistant Director
of Education

Eric A. Harvie,
The Investment Dealers'
Association of Canada,
Toronto.

PART II — THE I.D.A.C. - [illegible] — [illegible]

O F F I C E R S   A N D   C O M M I T T E E S

The Investment Dealers' Association
of Canada

[illegible]
55 Yonge Street, Toronto

Regional Office
132 St. James Street West, Montreal

OFFICERS 1961-62

President
Arthur J. Milner
Mills, Spence & Co. Limited, Toronto

[illegible]

J. William Ritchie,
[illegible] Company Limited,
Halifax.

W.M. Reay,
[illegible] and Company,
Limited, Montreal.

[illegible]
Burns Bros. & Denton Limited,
Toronto.

[illegible]

Eric S. Morse,
W.C. Pitfield & Company Limited

Honorary Vice-President

J. R. [illegible]
Royal Securities Corporation
Limited, Montreal.

Managing Director

[illegible]
The Investment Dealers' Association
of Canada, Toronto

[illegible],
W.C. Pitfield & Company
Limited, Winnipeg

K.M. Johnston,
Wood, Gundy & Company
Limited, Calgary

[illegible]
A.E. Ames & Co. Limited
[illegible]

[illegible]

[illegible],
Wood, Gundy & Company
Limited, Toronto.

Honorary Treasurer

[illegible],
Royal Securities
Corporation Limited,
Montreal.

Assistant Director
of Education

Eric A. Harvie,
The Investment Dealers'
Association of Canada,
[illegible]

THE I.D.A.C. - EXHIBIT D   PAGE 2

Secretary-Treasurer

W.S. Walter,
The Investment Dealers' Association of Canada,
Toronto.

Secretary Emeritus

J.A. Kingsmill,
The Investment Dealers' Association of Canada,
Toronto.

Auditors

Eakins and MacDonald,
Toronto.

Regional Director

L.F. Almond,
The Investment Dealers' Association of Canada,
Montreal.

Counsel

R.O. Daly, Q.C.,
Daly, Harvey & Cooper,
Toronto.

G.B. Foster, Q.C.,
Foster, Hannan, Watt, Leggat & Colby,
Montreal.

NATIONAL EXECUTIVE COMMITTEE

(The President, the Vice-Presidents and the Immediate Past President comprise the National Executive Committee).

ARTHUR J. MILNER, Toronto

J. WILLIAM RITCHIE, Halifax

W.M. REAY, Montreal.

D.S. BEATTY, Toronto.

D.J. LANGILL, Winnipeg

K.M. JOHNSTON, Calgary.

ROSS WILSON, Vancouver.

ERIC S. MORSE, Montreal.

THE I.D.A.C. - EXHIBIT D PAGE 2

Secretary-Treasurer

[illegible],
The Investment Dealers'
Association of Canada,
Toronto.

Secretary Emeritus

[illegible],
The Investment Dealers'
Association of Canada,
Toronto.

Auditors

Eakins and MacDonald,
Toronto.

[illegible]

L.P. Almond,
The Investment Dealers'
Association of Canada,
Montreal.

Counsel

[illegible], Q.C.,
Daly, Harvey & Cooper,
Toronto.

[illegible], Q.C.,
[illegible],
Leggat & Colby,
Montreal.

NATIONAL EXECUTIVE COMMITTEE

(The President, the Vice-Presidents and
the Immediate Past President comprise
the National Executive Committee).

ARTHUR J. MILNER, Toronto	D.J. LANGILL, Winnipeg
J. WILLIAM RITCHIE, Halifax	[illegible]
[illegible], Montreal.	ROSS WILSON, Vancouver.
D.S. BEATTY, Toronto.	ERIC S. MORSE, Montreal.

THE I.D.A.C. - EXHIBIT D PAGE 3

DISTRICT EXECUTIVE COMMITTEES, 1961-62

ATLANTIC DISTRICT

J. William Ritchie, Chairman	Eastern Securities Company Limited...Halifax.
H.D. Scully, Vice-Chairman	Nesbitt, Thomson and Company, Limited... Saint John.
C.E. Asprey	F.J. Brennan & Company Limited...Charlottetown
Adrian Bridgehouse	Gairdner & Company Limited...Halifax
Gerald R. Coyle, Secretary-Treasurer	Wood, Gundy & Company Limited...Halifax
J.D. Inches	Royal Securities Corporation Limited...Saint John.
William C. Lee	Stanbury & Company Limited ....Halifax
D.C. MacKay	W.C. Pitfield & Company, Limited...Saint John
W.P. MacMurray	Eastern Securities Company Limited...Saint John.
John M. Robinson	W.C. Pitfield & Company, Limited...Halifax
Elliott Spafford	Cornell, Macgillivray Limited....Halifax
J.A. MacMurray, Ex-officio	Eastern Securities Company Limited....Saint John

QUEBEC DISTRICT

W.M. Reay, Chairman	Nesbitt, Thomson and Company, Limited..Montreal
J.P.W. Ostiguy, Vice-Chairman	Morgan, Ostiguy & Hudon Ltd...Montreal
H.W. Andrews	Graham, Armstrong Securities Ltd...Montreal
B.E. de Breyne	L.G. Beaubien & Co. Limited...Montreal
M. David	Credit Interprovincial Inc....Montreal

THE I.D.A.C. - EXHIBIT D [illegible]

DISTRICT EXECUTIVE COMMITTEES, 1961-62

ATLANTIC DISTRICT

J. William [illegible], Chairman	[illegible] Securities Company Limited...Halifax.
H.D. Scully, Vice-Chairman	Nesbitt, Thomson and Company, Limited... Saint John.
[illegible]	F.J. Brennan & Company Limited...[illegible]
Adrian Bridgehouse	Gairdner & Company Limited...Halifax
Gerald R. Doyle, Secretary-Treasurer	Wood, Gundy & Company Limited...Halifax
[illegible]	[illegible] Limited...Saint John.
William C. Lee	Stanbury & Company Limited ...Halifax
[illegible]	W.C. Pitfield & Company, Limited...Saint John
[illegible]	Eastern Securities Company Limited...Saint John.
John M. Robinson	W.C. Pitfield & Company, Limited...Halifax
Elliott Spafford	Cornell, Macgillivray Limited...Halifax
J.A. MacMurray, Ex-officio	Eastern Securities Company Limited...Saint John

QUEBEC DISTRICT

W.M. Reay, Chairman	Nesbitt, Thomson and Company, Limited..Montreal
[illegible], Vice-Chairman	[illegible] Ltd...Montreal
[illegible]	[illegible]
[illegible]	L.G. Beaubien & Co. Limited...Montreal
[illegible]	[illegible]

D. Dlouhy	La Maison Bienvenu Limitee ....Montreal
G. Falardeau	J.T. Gendron Inc....Quebec City
L. Heslop	Bell, Gouinlock & Company, Limited...Montreal.
L.P. Letarte	La Corporation de Prets de Quebec ....Quebec City
R.W. MacKeen	Greenshields Incorporated ....Montreal
W.G. Pavey	W.C. Pitfield & Company Limited....Montreal
W.A. Stewart	Midland Securities Corpn. Limited....Montreal
J. Edgar Hill, Ex-officio	Royal Securities Corporation Limited....Montreal.

ONTARIO DISTRICT

D.S. Beatty, Chairman	Burns Bros. & Denton Limited...Toronto
D.R. Annett, Vice-Chairman	Annett & Company Limited... Toronto
Philip J. Chadsey	Wood, Gundy & Company Limited...Toronto
M.D. Cox	Anderson & Company Limited ...Toronto
Robert W. Gouinlock, Jr.	Bell, Gouinlock & Company, Limited....Toronto.
J. Ross Hilborn	McLeod, Young, Weir & Company Limited...Toronto
William N. Hovey	Equitable Securities Canada Limited...Toronto
E.P. Jarvis	Wisener, Mackellar and Company Limited...Toronto
L.E. Mayhew	Harris & Partners Limited ....Toronto
J.D. Schultz	Dominion Securities Corporation Limited...Toronto

C.R. Slipp	Wills, Bickle & Company Limited...Toronto
D.I. Webb	Merrill Lynch, Pierce, Fenner & Smith Incorporated.... Toronto
D.B. Shaw, Ex-officio	A.E. Ames & Co. Limited ...Toronto
A.J. Milner, Ex-officio	Mills, Spence & Co. Limited ....Toronto
Roy W. Hardaker, Ex-officio	Cochran, Murray & Co. Limited ....Hamilton
C.E. Medland, Ex-officio	Wood, Gundy & Company Limited ....Kitchener
R.A. MacDonald, Ex-officio	A.E. Ames & Co. Limited... London
V.S. Castledine, Ex-officio	V.S. Castledine & Company Limited....Ottawa.

MID-WESTERN DISTRICT

D.J. Langill, Chairman	W.C. Pitfield & Company, Limited...Winnipeg
J.D. Blyth	Royal Securities Corporation Limited....Winnipeg
M.J. Bulford	Greenshields Incorporated.... Winnipeg
W. Lyle Dyker, Secretary	Osler, Hammond & Nanton Limited...Winnipeg
W.E. Heaver	Nesbitt, Thomson and Company, Limited...Regina
John Graham, Jr.	Bell, Gouinlock & Company, Limited...Winnipeg
W.A. Kinch	Dominion Securities Corporation Limited..Winnipeg
A.K. McCord	A.E. Ames & Co. Limited ....Winnipeg
J.A. MacKnight	James Richardson & Sons ....Winnipeg
W.S. Dunlop, Ex-officio	Oldfield, Kirby & Gardner Limited...Winnipeg

- A -

THE I.D.A.C. - EXHIBIT D

ALBERTA DISTRICT

K.M. Johnston, Chairman	Wood, Gundy & Company Limited....Calgary
O.E. Buker	James Richardson & Sons ....Calgary
R. Copithorn	W.C. Pitfield & Company, Limited...Edmonton
Dennis Bessex	Nesbitt, Thomson and Company, Limited...Calgary
Lloyd J. Knowler	Osler, Hammond & Nanton Limited..Edmonton
Harold MacKeen	Toole, Peet Investments, Limited...Calgary
William Mathewson	McLeod, Young, Weir & Company Limited...Calgary
R. Montague	Dominion Securities (Alberta) Limited..Edmonton
Howard Ritchie	Sydie, Sutherland & Ritchie Ltd....Edmonton
T.W. Meredith, Ex-officio	Osler, Hammond & Nanton Limited...Calgary

PACIFIC DISTRICT

Ross Wilson, Chairman	A.E. Ames & Co. Limited ...Vancouver
A.H. Cater, Vice-Chairman	Royal Securities Corporation Limited...Vancouver
H.H. Dingle	Wood, Gundy & Company Limited...Vancouver
J.H. Lamprey	Yorkshire Securities Limited....Vancouver
G.H. Nation	Dominion Securities Corporation Limited ....Vancouver
H.B. Paterson	Norman R. Whittall Limited ....Vancouver
T.B. Read	Thomas B. Read Company Ltd. ....Vancouver

K.G. Russell	McLeod, Young, Weir & Company Limited...Vancouver
J.E. Smart	Pemberton Securities Limited, ...Vancouver
L.B. Williams	Hagar Investments Ltd.... Victoria
W. Tom Brown, Ex-officio	Odlum Brown Investments Ltd. ....Vancouver

NATIONAL BUSINESS CONDUCT COMMITTEE

Eric S. Morse, Chairman	W.C. Pitfield & Company, Limited....Montreal
Norman J. Alexander	James Richardson & Sons.... Winnipeg
E.H. Ely	Wood, Gundy & Company Limited ....Toronto
R.H. Dean	Nesbitt, Thomson and Company, Limited....Montreal
N.H. Gunn	Bell, Gouinlock & Company, Limited....Toronto

DISTRICT BUSINESS CONDUCT COMMITTEES

ATLANTIC DISTRICT

J.W. Ritchie, Chairman	Eastern Securities Company Limited...Halifax
J.A. MacMurray	Eastern Securities Company Limited....Saint John
R.C. Hebb	Dominion Securities Corporation Limited...Halifax
F.J. Brennan	F.J. Brennan & Company Limited...Saint John
G.W. Ramsay	Stanbury & Company Limited ....Saint John
J.D. Wood	Nesbitt, Thomson and Company, Limited....Halifax
H.L. Gassard, Ex-officio	The Investment Dealers' Association of Canada..... Toronto

THE I.D.A.C. - EXHIBIT D

QUEBEC DISTRICT

W.M. Reay, Chairman	Nesbitt, Thomson and Company, Limited...Montreal
J. Edgar Hill	Royal Securities Corporation Limited...Montreal
R.B. Casgrain	Casgrain & Company Limited ....Montreal
Andrew S. Beaubien	L.G. Beaubien & Co.Limited ....Montreal
Dudley Dawson	Greenshields Incorporated ....Montreal
E.F.C. Kinnear	W.C. Pitfield & Company, Limited....Montreal
H.L. Gassard, Ex-officio	The Investment Dealers' Association of Canada ....Toronto

ONTARIO DISTRICT

D.S. Beatty, Chairman	Burns Bros. & Denton Limited....Toronto
D. Bruce Shaw	A.E. Ames & Co. Limited ....Toronto
R.A. Daly, Jr.	R.A. Daly & Company Limited ....Toronto
Frank D. Lace	Matthews & Company Limited ....Toronto
R.K. Wright	Mills, Spence & Co.Limited ...Toronto
M.F. Newman	Cochran, Murray & Co. Limited...Toronto
H.L. Gassard, Ex-officio	The Investment Dealers' Association of Canada ....Toronto

MID-WESTERN DISTRICT

D.J. Langill, Chairman	W.C. Pitfield & Company Limited...Winnipeg
W.S. Dunlop	Oldfield, Kirby & Gardner Limited...Winnipeg
J.D. Bulgin	Dominion Securities Corporation Limited..Winnipeg

THE I.D.A.C. - SERIES D

QUEBEC DISTRICT

W.M. Reay, Chairman	Nesbitt, Thomson and Company, Limited...Montreal
J. Edgar Hill	Royal Securities Corporation Limited...Montreal
R.B. Casgrain	Casgrain & Company Limited ...Montreal
Andrew S. Beaubien	L.G. Beaubien & Co.Limited ...Montreal
Dudley Dawson	Greenshields Incorporated ...Montreal
E.F.C. Kinnear	[illegible] Limited...Montreal
H.L. Gassard, Ex-officio	The Investment Dealers Association of Canada ....Toronto

ONTARIO DISTRICT

D.S. Beatty, Chairman	[illegible] Limited...Toronto
D. Bruce Shaw	A.E. Ames & Co. Limited ...Toronto
R.A. Daly, Jr.	R.A. Daly & Company Limited ....Toronto
[illegible]	Matthews & Company Limited ...Toronto
[illegible] Wright	Mills, Spence & Co.Limited ...Toronto
M.F. Newman	Cochran, Murray & Co. Limited...Toronto
H.L. Gassard, Ex-officio	The Investment Dealers Association of Canada ...Toronto

MID-WESTERN DISTRICT

D.J. Langill, Chairman	W.C. Pitfield & Company Limited...Winnipeg
W.S. Dunlop	Oldfield, Kirby & Gardner Limited...Winnipeg
J.D. Bulein	Dominion Securities [illegible]

THE I.D.A.C. - EXHIBIT D PAGE 9

Kenneth Rothwell	A.E. Ames & Co. Limited ....Winnipeg
Charles McKelvie	James Richardson & Sons ....Winnipeg
G.S. Swindell	Wood, Gundy & Company Limited...Winnipeg
H.L. Gassard, Ec-officio	The Investment Dealers' Association of Canada ....Toronto

ALBERTA DISTRICT

K.M. Johnston, Chairman	Wood, Gundy & Company Limited...Calgary
T.W. Meredith	Osler, Hammond & Nanton Limited...Calgary
A.H. Turney	Locke, Gray & Company Limited...Calgary
W.V. Warner	James Richardson & Sons ...Edmonton
W.R. Taprell	Carlile & McCarthy Ltd.... Calgary
H.R. Farnsworth	Burns Bros. & Denton Limited...Calgary
H.L. Gassard, Ex-officio	The Investment Dealers' Association of Canada... Toronto

PACIFIC DISTRICT

Ross Wilson, Chairman	A.E. Ames & Co. Limited ...Vancouver
W.T. Brown	Odlum Brown Investments Ltd....Vancouver
A.G. Osburn	Pemberton Securities Limited...Vancouver
J.M. McAvity	W.C. Pitfield & Company Limited...Vancouver
J. Denis Hagar	Hagar Investments Ltd.... Victoria
G.D. Sherwood	Thomas B. Read Company Ltd...Vancouver

THE I.D.A.C. - EXHIBIT D   PAGE 2

Kenneth Rothwell	A.E. Ames & Co. Limited ...Winnipeg
Charles McKelvie	James Richardson & Sons ...Winnipeg
G.S. Swindell	Wood, Gundy & Company Limited...Winnipeg
[illegible], Ex-officio	The Investment Dealers' Association of Canada ...Toronto

ALBERTA DISTRICT

K.M. Johnston, Chairman	Wood, Gundy & Company Limited...Calgary
T.W. Meredith	Osler, Hammond & Nanton Limited...Calgary
A.H. Turney	Locke, Gray & Company Limited...Calgary
[illegible]	James Richardson & Sons ...Edmonton
W.R. Taprell	Carlile & McCarthy Ltd.... Calgary
[illegible]	Burns Bros. & Denton Limited...Calgary
[illegible], Ex-officio	The Investment Dealers' Association of Canada... Toronto

PACIFIC DISTRICT

[illegible], Chairman	A.E. Ames & Co. Limited ...Vancouver
W.T. Brown	[illegible] Ltd....Vancouver
[illegible]	[illegible] Limited...Vancouver
[illegible]	W.C. Pitfield & Company Limited...Vancouver
[illegible]	[illegible] Ltd.... Victoria
G.D. Sherwood	Thomas B. Read Company Ltd...Vancouver

H.L. Gassard, Ex-officio	The Investment Dealers' Association of Canada ....Toronto

DISTRICT ASSOCIATION AUDITORS

Lee & Martin	Maritime Life Bldg.	Halifax,NS	3-1311
Peat,Marwick, Mitchell & Co.	901 Victoria Square	Montreal	UN6-2693
Clarkson, Gordon & Co.	15 Wellington St.W.	Toronto,Ont	EM8-2751
Deloitte, Plender, Haskins & Sells	60 Osborne St.N.	Winnipeg,	SP4-1601
Peat,Marwick, Mitchell & Co.	508-309 8th Ave.W.	Calgary	AM6-6041
Buttar & Chiene	789 West Pender St.	Vancouver	MU3-6964

PAST PRESIDENTS

1916-1917	*William Hanson	Hanson Bros.	Montreal
1917-1918	*A.E. Ames	A.E. Ames & Co.Ltd.	Toronto
1918-1919	*J.M. Mackie	C. Meredith & Co.	Montreal
1919-1920	*Sir Augustus Nanton	Osler, Hammond & Nanton Ltd.	Winnipeg
1920-1921	*J.H. Gundy	Wood, Gundy & Co.	Toronto
1921-1922	*R.D. Bell	Greenshields & Co.	Montreal
1922-1923	#A.L. Crossin	Oldfield, Kirby & Gardner Limited	Winnipeg
1923-1924	*J.W. Mitchell	Dominion Securities Corporation Ltd.	Toronto
1924-1925	*J.A. Eccles	Harris, Forbes & Co.	Montreal
1925-1926	*L.W. Hicks	L.W. Hicks & Co.	Winnipeg
1926-1927	R.A. Daly	R.A. Daly Co.Ltd.	Toronto
1927-1928	*E.G. Hanson	Hanson Bros.	Montreal
1928-1929	*Harry Ford	Osler,Hammond & Nanton Ltd.	Winnipeg
1929-1930	*F.J. Coombs	A.E. Ames & Co. Ltd.	Toronto
1930-1931	*N.S. Brooke	Royal Securities Corporation Ltd.	Montreal

H.L. [illegible] Ex-officio	"The Investment Dealers' Association of Canada ..Toronto			

DISTRICT ASSOCIATION AUDITORS

Lee & Martin	Maritime Life Bldg.	Halifax,NS	3-1311
Peat,Marwick, Mitchell & Co.	501 Victoria Square	Montreal	[illegible]
Clarkson, Gordon & Co.	15 Wellington St.W.	Toronto,Ont	EM8-2751
[illegible], Haskins & Sells	60 Osborne St.N.	Winnipeg,	SP4-1601
Peat,Marwick, Mitchell & Co.	508-309 8th Ave.W.	Calgary	AM6-6041
Buttar & Chiene	789 West Pender St.	Vancouver	MU3-6964

PAST PRESIDENTS

1916-1917	*William Hanson	Hanson Bros.	Montreal
1917-1918	*A.E. Ames	A.E. Ames & Co.Ltd.	Toronto
1918-1919	*[illegible]	[illegible] & Co.	Montreal
1919-1920	*Sir Augustus Nanton	Osler, Hammond & Nanton Ltd.	Winnipeg
1920-1921	*J.H. Gundy	Wood, Gundy & Co.	Toronto
1921-1922	*R.D. Bell	Greenshields & Co.	Montreal
1922-1923	#A.L. Crossin	Oldfield, Kirby & Gardner Limited	Winnipeg
1923-1924	*[illegible]	Dominion Securities Corporation Ltd.	Toronto
1924-1925	*[illegible]	[illegible] & Co.	Montreal
1925-1926	*L.W. Hicks	L.W. Hicks & Co.	Winnipeg
1926-1927	R.A. Daly	R.A. Daly Co.Ltd.	Toronto
1927-1928	*E.G. Hanson	Hanson Bros.	Montreal
1928-1929	*Harry Ford	Osler,Hammond & Nanton Ltd.	Winnipeg
1929-1930	*F.J. Coombs	A.E. Ames & Co. Ltd.	Toronto
1930-1931	*[illegible]	Royal Securities	

THE I.D.A.C. - EXHIBIT D

1931-1932	*A.H. Williamson	Wood,Gundy & Co.	Vancouver
1932-1933	J.G. Weir	McLeod, Young,Weir & Company	Toronto
1933-1934	*W.C.Pitfield	W.C. Pitfield & Company Ltd.	Montreal
1934-1935	R.W. Gouinlock	Bell,Gouinlock & Co. Limited	Toronto
1935-1936	J.Ernest Savard	Savard,Hodgson & Co. Inc.	Montreal
1936-1937	*R.D. Baker	James Richardson & Sons	Winnipeg
1937-1938	#K.M. Pringle	Dominion Securities Corporation Ltd.	Toronto
1938-1939	D.K. Baldwin	Nesbitt,Thomson & Co. Ltd.	Montreal
1939-1940	W.P. Scott	Wood, Gundy & Co.	Toronto
June 1940- Nov. 1940	#E.C.Cumberland	Hanson Bros.	Montreal
Nov. 1940- Nov. 1941	*S.B. Hammond	Royal Securities Corporation Ltd.	Montreal
Nov. 1941-1942 June 1943	H.E. Cochran	Cochran,Murray & Co. Limited	Toronto
1943-1944	W.T.K. Collier	Collier,Norris & Quinlan Ltd.	Montreal
1944-1945	*A.G.A. Spence	Mills,Spence & Co.	Toronto
1945-1947	A.S. Torrey	W.C.Pitfield & Co.	Montreal
1947-1948	J.A.Gairdner	Gairdner & Co.Ltd.	Toronto
1948-1949	G.G. Ryan	L.G. Beaubien & Co. Limited	Montreal
1949-1950	#J.B. Ridley	A.E. Ames & Co.	Toronto
1950-1951	Peter Kilburn	Greenshields & Co. Inc.	Montreal
1951-1952	W.J. Borrie	Pemberton Securities Ltd.	Vancouver

THE I.D.A.C. - EXHIBIT D PAGE 12

1952-1953	H.S. Backus	McLeod,Young, Weir & Co. Limited	Toronto
1953-1954	Gerard Gingras	Rene-T. Leclerc, Incorporee	Montreal
1954-1955	J.R. Hughes	Royal Securities Corporation Ltd.	Montreal
1956-1957	N.H. Gunn	Bell,Gouinlock & Company,Limited	Toronto
1957-1958	R.H. Dean	Nesbitt,Thomson & Company,Limited	Montreal
1958-1959	E.H. Ely	Wood,Gundy & Co. Limited	Toronto
1959-1960	N.J. Alexander	James Richardson & Sons	Winnipeg
1960-1961	Eric S. Morse	W.C. Pitfield & Co.	Montreal

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* Deceased

Retired

THE I.D.A.C. - EXHIBIT G

CUMULATIVE RECORD OF COURSE RESULTS

Cumulative Record of New Enrollments from our Members and Passes (Excluding Readership and Other Enrollments)

COURSE 1

Jan. 1948 - June,1948	Enrolled	315	Completed	262
Jan. 1949 - June,1949	"	42	"	33
Apr. 1950 - Dec.,1950	"	104	"	64
Jan. 1951 - June,1951	"	137	"	93
Sept. 1951 - Mar.,1952	"	137	"	74
Sept. 1952 - June,1953	"	292	"	169
Sept. 1953 - June,1954	"	222	"	111
Sept. 1954 - June,1955	"	278	"	160
Sept. 1955 - June,1956	"	426	"	163
Sept. 1956 - June,1957	"	413	"	242
Sept. 1957 - June,1958	"	495	"	285
Sept. 1958 - June,1959	"	301	"	189
Sept. 1959 - June,1960	"	439	"	254
Sept. 1960 - June,1961	"	266	"	175
		3,867		2,274

COURSE II

Dec. 1948 - Feb.,1950	Enrolled	361	Completed	159
Apr. 1950 - Mar.,1951	"	41	"	19
May, 1951 - Apr.,1952	"	113	"	55
Sept. 1952 - June,1953	"	167	"	95
Sept. 1953 - June,1954	"	159	"	77
Sept. 1954 - June,1955	"	148	"	92
Sept. 1955 - June,1956	"	190	"	103
Sept. 1956 - June,1957	"	183	"	134
Sept. 1957 - June,1958	"	166	"	125
Sept. 1958 - June,1959	"	218	"	176
Sept. 1959 - June,1960	"	175	"	131
Sept. 1960 - June,1961	"	208	"	161
		2,129		1,327
Grand Total Enrollment both courses		5,996	Grand Total Completed	3,601

Percentage Completions

To June 1961 - 58.9 per cent of Course I students and 62.3 per cent of Course II students who enrolled completed the Course. In June 1961, the latest year available, 65.7 per cent of Course I students and 77.4 per cent of Course II students completed.

EXHIBIT C

CUMULATIVE RECORD OF COURSE RESULTS

Cumulative Record of New Enrollments from our Members and Passes (Excluding Readership and Other Enrollments)

COURSE I

Jan. 1948 - June,1948	Enrolled	315	Completed	[illegible]
Jan. 1949 - June,1949	"	42	"	[illegible]
Apr. 1950 - Dec.,1950	"	104	"	[illegible]
Jan. 1951 - June,1951	"	137	"	[illegible]
Sept. 1951 - Mar.,1952	"	137	"	[illegible]
Sept. 1952 - June,1953	"	292	"	[illegible]
[illegible]	"	[illegible]	"	[illegible]
Sept. 1954 - June,1955	"	278	"	[illegible]
Sept. 1955 - June,1956	"	426	"	[illegible]
Sept. 1956 - June,1957	"	413	"	[illegible]
Sept. 1957 - June,1958	"	495	"	285
Sept. 1958 - June,1959	"	301	"	[illegible]
Sept. 1959 - June,1960	"	439	"	[illegible]
Sept. 1960 - June,1961	"	266	"	[illegible]
		3,867		[illegible]

COURSE II

Dec. 1948 - Feb.,1950	Enrolled	361	Completed	[illegible]
Apr. 1950 - Mar.,1951	"	41	"	[illegible]
May, 1951 - Apr.,1952	"	113	"	[illegible]
Sept. 1952 - June,1953	"	167	"	[illegible]
Sept. 1953 - June,1954	"	159	"	77
Sept. 1954 - June,1955	"	148	"	[illegible]
Sept. 1955 - June,1956	"	190	"	[illegible]
Sept. 1956 - June,1957	"	183	"	134
Sept. 1957 - June,1958	"	166	"	125
Sept. 1958 - June,1959	"	218	"	176
Sept. 1959 - June,1960	"	175	"	131
Sept. 1960 - June,1961	"	208	"	[illegible]
		2,129		[illegible]

Grand Total Enrollment	[illegible]	Grand Total Completed	3,601

Percentage Completions

To June 1961 - 58.9 per cent of Course I students and 62.3 per cent of Course II students who enrolled completed the Course. In June 1961, the latest year available, 65.7 per cent of Course I students and 77.4 per cent of Course II students completed.

PART II - I.D.A.C. - EXHIBIT H

I.D.A.C. Adult Lecture Courses on "Understanding Investment Securities" - Fall, 1961 to Spring, 1962. Each course consisted of between 5 and 15 evening lectures.

Kitsilano High School, Vancouver, B.C.	93
Burnaby Public School, Burnaby, B.C.	17
Vancouver Technical School, Vancouver, B.C.	64
University of British Columbia, Vancouver, B.C.	153
University of Alberta, Edmonton, Alberta	75
University of Alberta, Calgary, Alberta	70
Regina Public School Board, Regina, Saskatchewan	44
University of Manitoba, Winnipeg, Manitoba	148
University of Toronto, Toronto, Ontario	80
Recreation Commission, Village of Forest Hill,Ont.	60
Recreation Commission, Leaside, Ontario	50
Young Men's Canadian Club, Toronto, Ont.	35
MacLean-Hunter Publishing Co.Ltd., Toronto, Ont.	110
Marsh & McLennan Ltd., Toronto, Ont.	50
Y.M.C.A. Adult Education Programme, Hamilton,Ont.	38
St. Catharines Public School Board, St.Catharines	25
Ottawa Public School Board, Ottawa, Ont.	50
University of Montreal, Montreal, P.Q.	152
McGill University, Montreal, P.Q.	255
University of Laval, Quebec, P.Q.	72
Bank of Montreal, Montreal, P.Q.	103
Saint Mary's University, St. John, N.B.	60
Total	1804

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX B

The Finance Department and Federal and Provincial Government Financing

Submitted by
THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

I N D E X

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX E

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and
Federal and Provincial Government Financing

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I N D E X

APPENDIX B - INDEX - Page 2

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

1. We have been invited to present a Brief to the Royal Commission on Banking and Finance. This portion of the Brief covers The Finance Department and Federal and Provincial Government Financing.

2. Within the framework of our particular subject and in accordance with the terms of reference, we will comment on The Finance Department, the investor who provides capital to the Federal and Provincial Governments and those who use it, the dealer who mobilizes capital and those legislative, functional and other influences which set the climate in which the users of capital and financial intermediaries operate. Our comments will be confined to the postwar period for two reasons:

(a) The second World War brought about such great changes in the Canadian debt structure and debt management that any study of conditions as they existed during the War or in the prewar period would have very little bearing on the subject now.

(b) The inflationary tendencies brought about by World War II and continuing through the postwar period have brought about fundamental changes in investor attitudes and decisions.

3. In the early years after the War, as a result of high taxation, increased living costs and continuous inflation, the investor became aware of the advisability

Nethercut & Young
Toronto, Ontario

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(b) The inflationary tendencies brought about by World War II and continuing through the postwar period have brought about fundamental changes in investor attitudes and decisions.

3. In the early years after the War, as a result of high taxation, increased living costs and continuous inflation, the investor became aware of the advisability

of having at least a portion of his money in securities giving him some protection against the continuous erosion in the value of the dollar. At the same time, he became aware that a new era of economic expansion was commencing and wished to share to the utmost in the economic growth of the country. This led the investor to put more of his worth into the shares of Canadian corporations and this tendency has been encouraged by Government policy through the introduction of the "dividend tax credit", which now stands at 20 per cent, as a means of fostering greater development and ownership of Canadian industry by Canadians.

4. The central weakness of the postwar years, insofar as the value of fixed income securities was concerned, was the result of the inflationary forces created during the War. The pent-up demand for all forms of consumer goods and social requirements such as housing, schools, highways, hospitals, etc., coupled with the development of new products and the world demand for our raw materials and semi-finished and finished products created a demand for labour, materials and capital of unprecedented size. The demand for labour was eased by returning veterans and an aggressive immigration policy. The demand for capital during the postwar period of expansion was satisfied by generation of new money through the buoyancy of the Canadian economy and importation of capital from abroad with an accelerated tendency towards importations of massive amounts during the period 1956 to 1961.

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4. The central weakness of the postwar years, insofar as the value of fixed income securities was concerned, was the result of the inflationary forces created during the War. The pent-up demand for all forms of consumer goods and social requirements such as housing, schools, highways, hospitals, etc., coupled with the development of new products and the world demand for our raw materials and semi-finished and finished products created a demand for labour, materials and capital of unprecedented size. The demand for labour was eased by returning veterans and an aggressive immigration policy. The demand for capital during the postwar period of expansion was satisfied by generation of new money through the buoyancy of the Canadian economy and importation of capital from abroad with an accelerated tendency towards importations of massive amounts during the period 1956 to 1961.

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and the general public, reduced the proportion of Federal Government bonds in their portfolios, not only through committing most newly acquired funds to investment in higher yielding obligations of provinces, municipalities and corporations as well as mortgages, but by selling holdings of Victory Bonds. These Victory Bonds were then retired by the Government through budgetary surpluses or acquired by the banking system where the acquisition resulted in the monetization of the equivalent portion of the national debt to the extent that the increase in the money supply exceeded the development of the economy.

6. During most of the postwar period, the Federal Government, by retaining by agreement or otherwise the main sources of taxation, operated with surpluses and the burden of finding new capital for expansion fell, for the most part, on the provinces, municipalities and private industry.

7. In the same period the Canadian dollar lost approximately 40 per cent of its purchasing value and to this extent, the investor who bought and retained fixed income securities of the Federal or Provincial governments was the loser. On the other hand, the investor who purchased the shares of a cross-section of leading Canadian corporations gained substantially due to the growth in capital value of his share portfolio.

8. As a result, there has been and is now a growing reluctance on the part of many investors to put other than a limited proportion of their funds into long-term bonds and unless inflationary tendencies are

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8. As a result, there has been and is now a growing reluctance on the part of many investors to put other than a limited proportion of their funds into long term bonds and unless inflationary tendencies are

checked this proportion is bound to decline.

9. This was the so-called "climate" in which money was raised in Canada and "climate" is still the most powerful single factor in investment decisions at most levels today.

The Investor or Provider of Capital

10. There are, of course, important institutional groups in the Canadian economy obliged to buy fixed income securities. Most important among these are insurance companies, banks, trust companies and pension funds, who buy fixed term dollar obligations to offset fixed term dollar liabilities. However, the pension funds to a greater degree than ever before are putting a larger percentage of their investable funds into the shares of Canadian corporations as an offset to the possible further decline of the buying power of the dollar.

11. There is still a segment of the public who buy fixed term obligations of the Federal and Provincial governments, as an adjunct to an equity portfolio for the purpose of providing a liquid reserve of cash with a market value at or near cost. However, for various reasons, there does seem to be a trend away from investment in long-term Government bonds by these private investors and Canada Savings Bonds have been substituted in most of these portfolios to the extent permitted.

12. Many corporations with strong working capital positions have money available for short periods of time. This money, to a great extent, is now being invested in

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short-term Federal Government securities. A good portion also is invested in other short-term debt instruments, but short-term Federal Government securities, because of their high degree of liquidity, are by far the largest element in this sector.

Fiscal Policies

13. The fiscal policies of the Federal and Provincial governments have a great bearing on the attitude of the investor. In the latter part of the period under review, the Federal Government accepted the principles of deficit financing as a stimulus to a lagging national economy, but recently proper weight does not seem to have been given to the corollary of surpluses and debt retirement in periods of prosperity. What tends to happen is that in periods of surpluses new government spending programmes are initiated in preference to debt retirement. If a proper approach was taken and it was coupled with a fixed annual sinking fund of 1 per cent per annum on all outstanding Federal Government issues over three years, a greater degree of investor confidence in the security and marketability of the medium and long-term bonds of the Federal Government would be generated. In this connection it is pointed out that most Provinces of Canada now provide sinking funds for both their direct and guaranteed issues as set forth in Exhibit 1. The sinking funds on Government of Canada medium and long-term issues need only operate until their terms to maturity are three years or less, since once an issue has been less than three years to run, it becomes part of the money market. It is normal policy for the central

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bank to operate in the money market and to purchase and hold a substantial proportion of the next maturing Government of Canada issue in order to provide for the orderly retirement or refunding of debt. This action will ensure an adequate market for three short-term issues without the need of action by the sinking fund.

Monetary Policy

14. It appears to us that there is a tendency for debt management policy to be unduly subordinated to monetary policy and the Investment Dealers' Association suggests that the Royal Commission inquire as to whether debt management and control of currency have conflicting interests and whether these functions should be separated.

15. If debt management and control of currency were separated and the Department of Finance reassumed the direct responsibility for the management of the national debt, with the exception of money market securities, it would have the effect of bringing the Department of Finance and the Cabinet into closer association with the problems of raising money in the capital markets to implement Government fiscal policies, which do not now adequately seem to reflect the requirements of sound debt management.

16. The Investment Dealers' Association also believes that the Commission should inquire into the Bank of Canada's role in operating the Purchase Fund and trading for Government accounts to determine whether these functions should be handled by the Department of Finance, or other trading agencies.

(Paragraphs 17 and 18 intentionally deleted).

The Bank Rate

19. Since November 1956, the Bank Rate has been set each week at a level of 1/4 of 1 per cent above the average rate on accepted tenders at the weekly auction of Government of Canada 3-month Treasury Bills.

20. Recently, this method of determining the Bank Rate has been the subject of a good deal of discussion and various views have been expressed. The Investment Dealers' Association feels that there is some merit in returning to the fixed Bank Rate as an instrument signalling important changes in monetary policy. If this were done, there would, of course, be a heavier penalty for chartered banks or money market dealers to using the rediscount privileges of the central bank. As far as the chartered banks are concerned, this would not be too onerous since they seldom use this privilege. However, for the money market dealers the "floating rate" has the advantage of limiting the penalty rate at which the dealers can borrow from the central bank. With a fixed Bank Rate there would be occasions when the cost of day loans would be above the running yield on Treasury Bills. At times when this occurred, dealers would be reluctant to hold large inventories and this in turn could tend to inhibit the size of the money market.

21. It therefore seems appropriate to study the possibilities of returning to an administered Bank Rate, which would clearly indicate the state of the Canadian economy, not only in relation to the internal

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situation in Canada, but also in relation to other major countries such as Great Britain and the United States. The Bank Rate would be the rate which signals important changes in monetary policy. In addition, and in order to continue to foster the growth of the money market, the money market participants should continue to have the right to sale and repurchase agreements with the Bank of Canada, to the extent of their lines of credit at the average tender for 90-day Bills, plus 1/4 of 1 per cent.

Overall Government Policy

22. We believe that the Government should pursue appropriate fiscal and monetary policies that have as their basic objective an adequate rate of economic growth which sustains a high level of productivity and employment and reasonable stability of prices. In addition to these objectives we believe the scope and quality of monetary and fiscal measures should be in keeping with the capacity of the Government to finance the national debt without straining its credit resources or impairing the confidence of investors at home and abroad in the integrity of the Canadian dollar and debt obligations of the Government of Canada. To maintain confidence in Government of Canada securities we feel that the authorities responsible for managing national debt should reiterate their belief in the following generally accepted basic principles of responsible debt management -

(a) Government securities must be sound and dependable investments.

(b) Extremes of inflation and deflation

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Overall Government Policy

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(a) Government securities must be sound and dependable investments.

(b) Extremes of inflation and deflation

should be avoided.

(c) The National Debt should be held by as great a number of individuals, institutions and corporations as possible.

(d) Fiscal policy should be directed towards continuous growth in relation to national income.

(e) Periods of budgetary deficits should be offset more equitably by periods of budgetary surpluses.

Comments on the Federal Debt

23. Exhibit II shows the distribution of the Federal debt under four main headings. The Bank of Canada, the chartered banks, Government of Canada accounts, such as unemployment insurance, securities investment and the general public. Exhibit III shows the Total Debt, the Average Term, the Amount of Total Debt under 3 years, the Percentage of the Total Debt under 3 years, the Population and the Debt Per Capita as of December 31st, 1946, 1951, 1956 and 1961.

24. During the period marketable debt declined from $16,044,000,000 to $14,575,000,000, but the amount of Canada Savings Loans outstanding increased from $469,000,000 to $4,079,000,000. Thus we are now in a position where out of a total debt of $18,599,000,000, only $8,362,000,000 or 45 per cent is for a fixed period of over 3 years; $6,158,000,000 or 33 per cent matures in under 3 years and a further $4,079,000,000 or 22 per cent consists of Canada Savings Bonds which represent a

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call on the Government at any time.

Marketing of New Issues and Investor Attitudes

25. In the last five years large Federal Government deficits have necessitated substantial annual increases in the debt. The marketing of the issues to cover the deficits was made possible to a large extent through the development of the money market. The one attribute which Federal securities should have which is not possessed in the same measure by any other security is their market liquidity. With the concentration by the Federal Government on the mass public market for new funds through the medium of Canada Savings Bonds, this liquidity, or ease of marketability, for fixed term securities has declined in recent years for all but the shorter maturities. This has meant that those financial institutions such as chartered banks, trust companies for their guaranteed investment account and corporations have tended to confine their investments to Government bonds of shorter maturity. In situations where an investor has chosen to buy longer term bonds the tendency has been towards the purchase of provincial, municipal or corporation bonds where a higher yield has been available with ample security and in many cases as satisfactory a degree of marketability due to the operation of sinking funds in the case of provincial and corporate securities.

Canada Savings Loans

26. Since their introduction in 1946, Canada Savings Bonds have become a significant element both in the debt structure and in the annual public borrowing operations of the Federal Government. Despite sizable

[illegible]

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redemptions for cash over the years, the outstanding amount of Savings Bonds has increased year by year since 1951 to nearly $4.1 billion, and is now equal to just under one-quarter of the public debt. To the end of December, applications for the 1961 Series, first offered in October, numbered in excess of 1 1/4 million for over $932 million of Bonds.

27. Savings Bonds are designed for individual investors of modest means but have been bought, within the limitations established for each issue, by larger investors. Being the equivalent of cash, they are the most suitable and have become the most acceptable form of risk-free investment for persons who are unable or unwilling to assume the risks of the price declines which can occur in market type securities. For these reasons, it seems certain that the kind of personal savings mobilized for Government use by the issue of Savings Bonds is, to some extent, a body of funds which would not be invested in other forms of securities if Savings Bonds were not available each year for public purchase.

28. While the prime reason for the annual sale of Savings Bonds is to provide part of the cash required to finance Government expenditures, they also serve other important purposes. For example, they encourage the ownership of liquid assets by a large number of families which might not otherwise be inclined to save. Then, by increasing greatly the number of persons who have some direct ownership of securities, the Savings Bond programme over the years has undoubtedly widened public interest in securities.

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29. Benefits and advantages of Savings Bonds to the individual investor and to the Canadian economy are costly to the issuer. From available evidence, it is certain they are costly to sell and to service because cash redemptions well before final maturity date constitute a high proportion of original sales. (See Exhibit 4). This means a large part of the funds realized from the sale of each Series is available to Government use for only a relatively short period. Then, because they confer the right of cash redemption, Savings Bonds are, in effect, demand obligations which currently aggregate the sizable magnitude of over $4 billion. Through control of the money supply, the Federal Government can always pay its debts. But, increasing the money supply to finance debt retirement is not always a sound course of action. For this reason, there could be times when Government borrowing operations to raise funds for Savings Bond redemptions would impose undesirable burdens on the capital market.

30. From this brief outline, it is evident that the economic dangers and financial costs inherent to Savings Bonds impose a limitation on their use as an instrument of debt management policy. Their advantages can be purchased at too high a price. Moreover, their use by borrowers other than the Federal Government involves even greater risks.

31. The great difficulty lies in fiscal policy. Had fiscal policy not led to large deficits in the last few years, it is possible that Savings Loans, as a major money raising vehicle, would not have been used to the

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same extent. The solution to the problem lies in smaller deficits on the part of the Federal Government and less reliance on Savings Loans with a greater emphasis on fixed term securities as a means of raising governmental requirements.

Recommendation

32. We recommend that Canada Savings Loan issues in the future be offered as a pure savings instrument and that the maximum amount available to any one buyer be examined. Originally, Canada Savings Loan issues were made with the idea of educating the small buyer to the theories of thrift, but recently, there has been a tendency to use this method of financing as a major money raising vehicle. The general consensus of opinion of the members of the Investment Dealers' Association is that the maximum amount to any one buyer should not exceed $5,000 and that the selling emphasis should be in the area of the payroll savings for the small investor. If this approach was taken it would, of course, be necessary, if the demand for new money persists, to raise the greater percentage of the Government's requirements through the medium of issues with a fixed maturity.

Federal and Provincial Financing in the Last Ten Years Under Review

33. As we entered the 1950's, it was obvious that the investor climate had shifted for reasons outlined in the previous paragraphs and it was therefore no longer possible for the Government to continue to borrow the appropriate portion of its requirements in the long-term sector. It was in this period that the Conversion Loan

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33. As we entered the 1950's, it was obvious that the investor climate had shifted for reasons outlined in the previous paragraphs and it was therefore no longer possible for the Government to continue to borrow the appropriate portion of its requirements in the long-term sector. It was in this period that the Conversion Loan

of 1958 was conceived as a refunding operation to lengthen the overall maturity of the debt. The provinces, with credit only second to the Government of Canada, could always offer their issues to give a higher yield and the public was demanding a portion of its investment in shares to offset the inflationary tendencies of the economy.

34. It was therefore necessary for the Government to tap other sources for their new money requirements. These sources were demanding shorter-term securities with a high degree of liquidity. In line with this demand the Government encouraged the development of the money market at the same time that investor psychology was changing. This enabled the Government to raise its necessary requirements in the short-term area and left the long-term market, except for C.N.R. financing, free for the provinces, and other long-term borrowers. Most provincial borrowing is for long-term projects and long-term debt should be issued against these projects. In some instances, the provinces have used the short-term market for fixed term securities and savings loans and other routes. This method of provincial financing, particularly in the case of provincial savings loans should be limited, as the provinces are not in control of currency and credit.

35. It appears to us that it is not vital to have the average term of the Federal debt extended to its absolutely attainable length. However, having in mind that Federal borrowing is not only to finance deficits and refund maturing obligations, but to provide

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funds for government agencies who normally require long-term debt, such as the Canadian National Railway, St. Lawrence Seaway, housing, etc., it is only sound practice that our Federal debt should be for a somewhat longer period than its counterpart in the United States where Government agencies also borrow for their own account. In the United States the average term of the marketable debt was 4 years and 7 months as of December 31st, 1961 and the comparable figure for Canada was 8 years and 4 months.

36. There will be periods in the future as in the past when depressed conditions in Canada indicate that the money supply can be increased without inflationary implications. This is a time when a greater proportion than otherwise of the investment dollar flows into debt securities. It is in such times that long-term debt can be issued or major conversion opportunities arise for a lengthening of the average term of the Federal debt.

RECOMMENDATIONS

37.

1. In times of high business activity, government should budget for surpluses which should be used to retire debt and not for the development of new government spending programmes. Sinking funds on long-term Federal issues, such as exists on provincial debt, would materially assist orderly marketing.

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2. Every effort should be made to reduce the Government's reliance on Savings Loan issues as a major money raising vehicle.

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3. Because of the nature of provincial requirements, provinces should only resort to short-term Fixed Maturity debt instruments when long-term money is not available.

40.

4. Since the provinces are not in control of currency and credit the use of Savings Loan type of issues should be sharply curtailed.

41. For comparative purposes and in order that a proper assessment of our own methods of financing of the Federal and provincial governments in Canada may be made, it seems appropriate to review the methods employed in the United Kingdom and the United States and draw some conclusions.

Comparison Between Canada and the United Kingdom

42. During the period under review, 1946 to 1961, the market in the United Kingdom for British Government and local authority issues (the latter being the equivalent of our provincial issues) has exerted very little influence on the level of the Canadian high-grade market. In our opinion, therefore, it is unnecessary to make an exhaustive comparison of the two markets,

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except to comment on the different methods employed in the two markets to raise capital for similar types of issues.

43. In Britain the Bank of England controls the terms and time of issue in the categories under review. There are three main categories used in Britain as follows:

1. Treasury Bills

44. As in Canada, Treasury Bills in Britain come up for tender once a week. Unlike Canada, the British banks do not tender for Bills for their own account, but meet their requirements by purchasing Bills from the discount market, which is comprised of a group of discount houses, nominated by the Bank of England, which are members of the London Discount Market Association, and each week these members put in one composite bid for the entire tender. The British banks and others then purchase their requirements from the discount houses at the then market level.

2. British Government

45. British Government issues are made through the Bank of England which pays a commission to banks and dealers for orders received and accepted. If the issue is not entirely subscribed for in this manner, theissue is announced as having been fully subscribed, the balance being underwritten by the Issue Department of the Bank of England and gradually sold into the market at the going rate by the Government dealer, and the price at which the security is eventually sold is therefore, in effect, the issue price.

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3. Local Authorities

46. Local authorities, which are in effect the equivalent of our provincial issues, usually employ a dealer to advise them on the terms and conditions of the issue for a fee, usually 1/4 of 1 per cent. In the first instance an issue is fully underwritten by a group consisting of all types of financial institutions. The underwriting group receives a fee of from 3/4 per cent to 1 per cent, depending on whether the operation is a conversion offer or to raise new money. In addition to the above charges a commission (allowance) of 1/4 of 1 per cent is paid to banks and dealers on allotments made in respect of their applications. Thus the total costs in this respect are between 1 1/4 per cent and 1 1/2 per cent. The issues are made by public subscription with advertisement in the press inviting applications. If the issue is fully or over-subscribed by such public subscriptions, the underwriting institutions mentioned receive no allotment in respect of their underwriting. Thus if they wish to subscribe to the issue they have to make application along with the rest of the investing public. If the issue is not fully subscribed the underwriters receive their proportion of the unsubscribed amount which is either retained as a permanent investment or sold in the market at the going quotation.

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1. The method employed in Canada for Treasury Bill financing seems more suitable than the method employed in the United Kingdom for this market. The "one bid"

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method employed in Britain is suited to the special conditions of that market and is not strictly comparable with the method of operation in Canada.

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2. Direct British Government financing is carried on in much the same manner as in Canada except that in Canada it has been the practice of the Bank of Canada, acting as agents for the Government, to give dealers a firm amount of bonds on announcement of the new issue in order that confirmation can be given to the dealers' customers. We feel that the system employed in Canada is more appropriate for our market in that it allows immediate confirmation to the customer and gives dealers the ability to accurately appraise the demand when they subscribe for additional bonds.

49.

3. The financing of local authorities is similar to the way our provinces are financed in Canada insofar as they are done through a dealer manager, but at this stage the similarity stops. All the manager does is set the issue up for a fee and then orders may flow in direct to the local authority and allotments are made.

50.

4. In the case of Canadian provincial issues, the most accepted and, in our opinion, the best method is to appoint a manager, who forms a strong group of underwriters. After consultation with the borrower and the senior members of the underwriting group, a bid for all or part of the issue is made to the province

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concerned. It is then the responsibility of the dealer group to merchandise the securities in which it has a definite liability. The fact that the group has a liability makes it essential that it distributes the securities as quickly as possible and also develops for the province concerned the most widespread and steady market for its issue.

Comparison Between Canada and the United States

51. Because of the importance which the United States Government bond market exerts on the Canadian Government bond market, a more thorough review seems to be in order. Basically, the interest rates in the United States and in Canada bear a definite relationship and since we in Canada operate in the dollar area, there is a substantial flow of capital between the two countries. This flow has the effect of arbitrage and tends to keep what is regarded as a proper yield spread between the two markets, taking into account the yield obtainable in the comparable credits of the two markets and the level of our dollar in relation to the United States dollar. The essential difference between Canada and the United States in the distribution of direct Federal government securities lies in the lack of any compensation in the United States to dealers and dealer banks through whom the issues eventually reach the investor.

52. In a country such as the United States which has reached the stage in its development where it is creating savings at a greater rate than they can be employed, this system can perhaps be justified. It does, however, mean that Government issues handled in this way

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do not find their way into the broad public market. There is therefore no public market such as we have in Canada for Government securities. So United States Government debt securities tend to be held in the main by Government accounts, banks, insurance companies, trust companies, pension funds and other semi-institutional pools of investment capital. This is accounted for by the tax exempt United States State bonds being available to private investors in the United States and not in Canada.

Government Treasury Bill Market

53. The Government Treasury Bill market is handled much the same as in Canada. These Bills are sold at auction once a week. A group of seventeen accredited dealers and banks, which have been recognized as purchasers by the Open Market Committee, bid on the Bills, and market them in a similar way to that which is employed in Canada.

54. In the United States the equivalent of the provincial issues are the State issues. The method of marketing is similar in some ways to the Canadian method in that new issues are either sold by public tender to a group of dealers of whom one is the manager, or the manager of a group negotiates the price and terms on behalf of his group. The marketing then takes place in a similar way to that which is employed in Canada.

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(Paragraph 56 deleted intentionally).

57.

1. No recommendations seem necessary as far as the method of handling Treasury Bills in our market is concerned. It is pointed out, however, that in the United States, the seventeen accredited dealers and banks are the only bidders, whereas in Canada any dealer can make a bid at the auction. Although in practice only the dealers nominated to the money market make a bid.

58.

2. The method used by the United States Federal Government to raise money would not, in our opinion, do the job in Canada. The fact that the United States government pay no conecession for distribution means that their distribution is limited as pointed out in previous paragraphs. The one thing which is required in Canada is widespread public distribution and this can only be secured by paying the dealers a compensation for distribution.

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3. In view of the fact that United States State bonds are exempt from Federal Taxation and also exempt from any State income taxes levied by that State, it is difficult to derive any definite conclusions

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between the two markets.

Marketing of New Issues

60. We have discussed marketing procedures in Great Britain and the United States. The following paragraphs will be devoted to the marketing of new Government of Canada and provincial issues in Canada.

Government of Canada Issues

61. The timing and terms of Government of Canada issues are determined by the Finance Department on advice from its agent, the Bank of Canada. The amount required in any one year is determined by the amount of maturing obligations in that year, plus the new money requirements, if any. During the first ten years under review, the Federal Government enjoyed surpluses, with the exception of 1946 and 1955, and their outstanding unmatured debt decreased from $17,313,000,000 in 1946 to $15,334,000,000 in 1951 and $15,234,000,000 in 1956. The marketing, therefore, of new issues was almost entirely confined to refunding and did not present a problem of any great magnitude. However, in the last five years, with one exception, the Federal Government has experienced large deficits, with the result that the problem of new public issues has been considerably expanded as witnessed by the increases in the Federal debt to $18,599,000,000 as at December 31st, 1961.

62. Various techniques have been evolved through experience. Recently new issues have been confined to the short-term area which has allowed other borrowers, such as the provinces, to enjoy as much

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62. Various techniques have been evolved through experience. Recently new issues have been confined to the short-term area which has allowed other borrowers, such as the provinces, to enjoy as much

freedom as possible in the long-term market. All Government issues have been marketed through normal dealer channels and with some exceptions firm participations have been given to dealers for distribution to their customers.

63. There has been some criticism that the list of primary distributors are, in fact, not normally engaged in the distribution of Government securities and it is recommended that the list of primary distributors be thoroughly overhauled in order that the best possible public distribution be secured for the Government under present conditions. Another point which deserves study is the recent trend towards new issues by the Government, being taken up entirely by the Bank of Canada and then marketed at a later date. Between the time these issues are announced and the time they are available in the market, the dealer must make an educated guess on what the price will be and hope to provide fair value to the investor. This does not induce proper widespread distribution and does foster a certain amount of speculation which is undesirable, particularly in the securities of the Government of Canada.

64. The price of the issue, which is entirely taken up by the Bank of Canada and marketed in the manner outlined above, is publicly announced. The price at which the issue is traded one week later inevitably is either above or below the announced issue price with all the market repercussions which this sort of an operation creates. In addition, the issue price may be too high and subsequent demand therefore so limited

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that a very small percentage is held by the public with a consequent thin after-market.

RECOMMENDATIONS ON GOVERNMENT FINANCING

65. In order that the experience and technical marketing skills and knowledge of the investment industry, which is in close and daily touch with the ultimate buyer of Government of Canada securities, be effectively centralized and made available to the debt managers, it is recommended that a standing committee on the marketing of Government of Canada Bonds be established by government decree. This committee would act in an advisory capacity to the Bank of Canada and the Department of Finance in connection with the marketing of Government of Canada issues and problems arising therefrom or related thereto. It should be comprised of men of experience and independent judgment in the field of Government finance drawn from the investment industry and, if deemed necessary, from other segments of the financial community. The Committee should be workable in size to facilitate decision-making and ease of consultation in Ottawa when requested by the Bank of Canada and/or the Department of Finance. Its composition should recognize the geographical location of the various financial centres of Canada with appropriate weight being given to their size and importance.

RECOMMENDATIONS ON C.N.R. FINANCING

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should be handled in a similar way to that of the financing of the larger provinces. That is, a large national syndicate should be formed headed by a dealer or group of dealers to be chosen by the Department of Finance in consultation with the C.N.R. and the Bank of Canada. In fact, there was in existence until such financing came under the direction of the Bank of Canada. The manager, or managers, would then form a banking group composed of the dealers in Canada, who usually underwrite and take a liability and who would be available for prior consultation on timing, size, maturities and prices of new issues to be brought to the market. In addition to this, there should be a selling group of all other distributors of Government securities in Canada. There will inevitably be some dealers who are designed as selling group members, who will feel they should be members of the banking group. Their proven distributing power would be the deciding factor as to whether they are members of the banking group or the selling group, and this should be decided in consultation with the C.N.R., the Finance Department, the Bank of Canada and the management group.

Provincial Financing

67. As we entered the 1950s, it was obvious that the investor climate had shifted for reasons outlined in the opening paragraphs of this Brief and it was at this time that the requirements of the provinces were becoming very large as a result of huge expenditures which had to be made for hospitals, roads, schools, public utilities, etc.

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69. Since there are not enough large pools of money in Canada to finance the requirements of the provincial governments, it has become increasingly evident that broad public distribution is the only way in which the provinces could raise their requirements. It is apparent that these large requirements can only be raised through the medium of continuing strong national syndicates, with the exception of provinces whose requirements are not large.

70. The issues are usually negotiated by the syndicate manager, who has the benefit of advice from what is known as a steering committee. This committee is made up of qualified persons from members of the syndicate whose judgment have been time proven. Once the price and terms have been settled the syndicate, which is handling the issue, takes a liability. This liability is the driving force behind the dealer fraternity to distribute the securities to the public and is one of the reasons why there is such a broad,

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healthy interest in provincial issues. The syndicate also has a further responsibility of continuing to foster the market for provincial securities between new issues and keep the provinces informed of market conditions. We cannot stress too strongly the fact that provincial borrowing is for long-term projects and long-term debt should be issued against these projects. In some instances, the provinces have used the short-term market for dated securities and savings loans and other routes. This method of provincial financing, particularly in the case of provincial savings loans, should be limited as the provinces are not in control of currency and credit.

Method of Distributing Provincial Securities to the Public

71. Whether the distribution of provincial securities to the public is made through a single dealer or a syndicate composed of a number of dealers, the process is the same. The issue is either purchased by public tender or the purchase is at a negotiated price. Once this has taken place the issue is set up to offer to the public. The retail price is set, concessions to sub-agents and dealers announced to the trade, and a decision is reached as to whether there will be a selling group or not. The decision to have a selling group is governed by the size of the issue. On relatively small issues, widespread distribution is not required and, therefore, there would not normally be a selling group, but on larger issues, there usually is a selling group and this group is usually composed of members of the

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I.D.A. who are not the original buyers of the issue or who are not in the syndicate who purchase the issue.

72. The terms are set and usually 50 per cent to 60 per cent of the issue is confirmed to the underwriting group for sale to their clients. The remainder is reserved for the exempt institutions and selling group. Exempt institutions are made up of all the large insurance companies, trust companies and banks. The amount of bonds purchased by the exempt institutions varies very widely depending on the amount of money they have available for investment at the time. The amount of bonds confirmed to the selling group varies to some extent depending on the size of the issue, with the selling group usually receiving a larger percentage of the amount on large issues. In small issues adequate allotments to the selling group present a problem for the 189 members of the I.D.A.

73. If exempt institutions and the selling group do not subscribe for the amount set aside for them it is obviously the liability of the originating group to absorb this amount into their own book and do the distribution themselves. If the selling group dealers subscribe for more than is normally available to them the originating syndicate tries to make a further amount available out of their own firm bonds or perhaps take a short position not only for after-market operations but in order that selling group members get as fair treatment as possible under the market conditions then existing.

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RECOMMENDATIONS

74.

1. Due to the nature of provincial requirements provinces should only resort to short-term fixed maturity debt instruments when long-term money is not available.

75.

2. Since the provinces are not in control of currency and credit, the use of savings loan types of issues should be sharply curtailed.

76.

3. We recommend that provincial financing, except for small issues should be handled by large national syndicates headed by the managing firm, which in turn should be backed up by a steering committee composed of qualified persons frommembers of the syndicate. It is in this way that a continuous broad, healthy market will be maintained for provincial securities in Canada.

REFERENCES	SUMMARY OF RECOMMENDATIONS
	The Association recommends:
Pr. 13 Pages A.170 to A.171	(a) that Government of Canada issues with maturities in excess of three years should have an annual sinking fund of 1 per cent of their principal amount;
Pr. 14 Page A.171	(b) that the Commission enquire as to whether debt management and control of currency have conflicting interests and whether these should be separated.

Pr. 16 Page A.171

(c) that the Commission should enquire into whether Bank of Canada or some other agency should operate the purchase fund and government accounts.

(d) that consideration be given to establishing two separate bank rates as follows:

Pr. 19 Page A.172 to Pr. 21 Pages A.172 and A.173

(i) a rediscount rate for chartered banks and money market dealers established on the basis as the present so-called "floating rate", and

(ii) a fixed Bank Rate to signal important changes in monetary policy and consequently the prime lending rate of Chartered Banks;

Pr. 22, Page A.173

(e) that the Government reiterate its belief in the generally accepted basic principles of responsible debt management;

Pr. 26 Pages A.175 and A.176

(f) that serious consideration be given to changing the 1962 fall Savings Loan Campaign by combining a smaller Canada Savings Loan issue with a fixed term issue;

Pr. 33, Page A.178 to Pr. 40, Page A.181

(g) (i) that the Government should budget for surpluses in periods of high business activity for the purpose of debt retirement;

(ii) that the Government rely less on Canada Savings Bonds as a major vehicle

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Pr. 16 Page A.171

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Pr. 25 Pages A.175 and A.176

(g) (i) that the Government should budget for surpluses in periods of high business activity for the purpose of debt retirement;

Pr. 33, Page A.175 to Pr. 40, Page A.181

(ii) that the Government rely less on

for raising money;

(iii) that Provincial Governments sharply curtail the use of Savings Loans type of issues as a money-raising vehicle and only use short-term fixed debt instruments for such purposes when long-term money is not available;

Pr. 42, Page A.181 to Pr. 50 Page A.184

(h) that the present methods employed in Canada for Treasury Bill financing, the direct placement of Government of Canada issues and the underwriting of Provincial issues be continued in preference to the methods used in the United Kingdom for comparable issues in that market;

Pr. 51, Page A.185 to Pr. 59 Page A.187

(i) that the present methods employed in Canada for Treasury Bill financing, the direct placement of Government of Canada issues and the underwriting of Provincial issues, while similar in many respects to United States practises, be continued in preference to the methods used in the United States for comparable issues in that market;

Pr. 61, Page A.188 to Pr. 65, Page A.190

(j) that a standing committee on the marketing of Government of Canada Bonds, to comprise men from the financial community having experience and independent judgment in the marketing of Government of Canada Bonds, be established by Government decree to act in an advisory capacity

for raising money;

(iii) that Provincial Governments sharply curtail the use of Savings Loans type of issues as a money-raising vehicle and only use short-term fixed debt instruments for such purposes when long-term money is not available;

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Pr. 61, Page A.188 to Pr. 65, Page A.190

to the Bank of Canada and the Department of Finance in connection with the marketing of Government of Canada issues;

Pr. 66, Pages A.190 to A.191

(k) that future financing of the Canadian National Railways, and other Government agencies requiring long-term financing, be arranged through large national syndicates of investment dealers managed by one or more dealers selected by the Department of Finance in consultation with the Canadian National Railways and the Bank of Canada;

Pr. 67, Page A.191 to Pr. 76, Page A.195

(l) that Provincial financing, except small issues, should continue to be arranged through large national syndicates of investment dealers managed by one or more dealers backed up by a steering committee composed of qualified persons selected from members of the syndicate.

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EXHIBIT 1

Issue	Sinking Fund
Province of Alberta Municipal Financing Corporation	2% of the principal amount annually.
Province of Manitoba	1% to 3% of the principal amount annually.
Manitoba Hydro-Electric Board	1% of the principal amount annually plus 4% on balance in the Sinking Fund Account.
Province of New Brunswick	2% to 3% of the principal amount annually.
Province of Newfoundland	1 3/4% to 3% of the principal amount annually.
Province of Nova Scoita	3% of the principal amount annually.
Province of Ontario	Appropriations made annually to a general sinking fund. Several issues have specified sinking fund arrangements.
Hydro-Electric Power Commission of Ontario	Annuity method, using a 4% interest rate, applied to value of operating properties which are written off over 40 years.
Province of Prince Edward Island	3% of the principal amount annually.
Province of Saskatchewan	3% of the principal amount annually.
Province of Quebec	1% of the principal amount annually.
Quebec Hydro-Electric Commission	1% of the principal amount annually with respect to shorter maturities and 2% of the principal amount annually with respect to longer maturities.

EXHIBIT II

DISTRIBUTION OF GOVERNMENT OF CANADA SECURITIES
As at December 31st
(in millions of par value)

Year	Total Debt	Bank of Canada	As % of Total Debt	Chartered Banks	As % of Total Debt	Govt. of Canada Accounts	As % of Total Debt	General Public Holdings Market*	Non-Market**	Total	As % of Total Debt
1946	17,313	1,904	11.00%	3,317	19.16%	918	5.30%	9,937	1,237	11,174	64.54%
1951	15,334	2,222	14.49	2,830	18.46	1,009	6.58	8,079	1,194	9,273	60.47
1956	15,234	2,426	15.92	2,524	16.57	1,518	9.96	6,225	2,541	8,766	57.55
1961/	18,599	2,856	15.35	3,786	20.36	658	3.54	7,221	4,079	11,300	60.75

* This denotes the amount of the Federal Government debt held by the General Public exclusive of Savings Loan Bonds.

** This denotes the amount of Savings Loan Bonds held by the General Public.

/ As at January 2, 1962 from figures supplied by the Bank of Canada.

Source: Bank of Canada "Statistical Summary Supplement 1960" Government of Canada Direct and Guaranteed Securities Distribution of Holdings.

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EXHIBIT III

DISTRIBUTION OF GOVERNMENT OF CANADA SECURITIES

Year	Total Debt	Average Term (excl. Savings & Perpetuals**) Years and Months	Under 3 Years	Under 3 Years as % of Total Debt	Population	Debt Per Capita***
1946	$ 17,313	9 - 11	$ 3,211	18.55%	12,292,000	$1,408.48
1951	15,334	7 - 6	3,691	24.07	14,009,429	1,095.12
1956	15,234	6 - 7	4,727	31.03	16,080,791	947.34
1961	18,599	8 - 4	6,158	33.11	18,400,000	1,010.82

* In millions

** Savings Loan Bonds and Perpetuals have been excluded in arriving at the average term due to the fact that Savings Loan Bonds may be cashed at any time at the holder's option and the Perpetuals have no fixed maturity.

*** The debt per capita represents all outstanding debt.

Source: Bank of Canada "Statistical Summary Supplement 1960", Bank of Canada Statements and from figures supplied by the Bank of Canada.

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EXHIBIT IV (a) CANADA SAVINGS BONDS

It has been assumed that the amount of each issue outstanding at January 1st represents the total sales of such issue. The January 1st figure represents on the average approximately 90 per cent of total sales.

Total Sales (1946 Series 1 to 1961 Series 16)	$10,408,715,000
Total Amount outstanding as at January 1, 1962	4,079,000,000
Amount of Redemption and Maturities	$ 6,329,715,000
Total amount of issues maturing during period (1947-1961)	$ 1,503,172,000
Resulting amount of Redemption during period (1947-1961)	$ 4,826,543,000

Redemption as a percentate of Total Sales	46.4%
Maturing issues as a percentate of the Total Sales	14.4%
Total Amount at January 1, 1962 as a percentage of Total Sales	39.2%
	100.0%

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EXHIBIT IV (b)

CANADA SAVINGS BONDS

ANNUAL AMOUNTS OUTSTANDING
AS OF JANUARY 1st

(Thousands of Dollars)

Year	Series 1 (1946)	Series 2 (1947)	Series 3 (1948)	Series 4 (1949)	Series 5 (1950)	Series 6 (1951)	Series 7 (1952)	Series 8 (1953)	Series 9 (1954)	Series 10 (1955)	Series 11 (1956)	Series 12 (1957)	Series 13 (1958)	Series 14 (1959)	Series 15 (1960)	Series 16 (1961)	Total	Net Dollar Increase	Total Sales Of Issue *
1947	$469,251	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 469,251	$469,251	$ 535,285,550
1948	416,963	256,014	-	-	-	-	-	-	-	-	-	-	-	-	-	-	672,977	203,726	287,733,100
1949	338,296	201,795	230,929	-	-	-	-	-	-	-	-	-	-	-	-	-	771,020	88,043	260,491,150
1950	292,237	160,893	176,205	282,856	-	-	-	-	-	-	-	-	-	-	-	-	912,191	141,171	320,200,000
1951	252,296	135,634	133,027	214,182	264,122	-	-	-	-	-	-	-	-	-	-	-	999,261	87,070	285,600,000
1952	206,361	109,731	104,719	153,970	166,551	351,474	-	-	-	-	-	-	-	-	-	-	1,092,606	93,345	394,642,400
1953	175,371	92,901	87,385	126,799	118,738	265,610	331,986	-	-	-	-	-	-	-	-	-	1,198,790	106,184	380,761,100
1954	99,784	52,905	48,642	71,208	66,708	173,342	219,516	840,633	-	-	-	-	-	-	-	-	1,572,738	373,946	850,548,900
1955	72,717	38,641	35,756	52,603	48,928	152,747	173,354	722,874	792,356	-	-	-	-	-	-	-	2,089,976	517,238	800,540,900
1956	58,306	31,142	28,682	42,357	39,049	139,537	154,913	647,549	628,363	649,824	-	-	-	-	-	-	2,419,722	329,746	729,100,000
1957	-	22,937	21,075	31,449	28,752	120,783	137,708	579,720	369,189	404,225	792,441	-	-	-	-	-	2,508,279	88,557	853,810,150
1958	-	-	14,768	22,326	20,399	82,481	97,185	386,510	203,364	208,935	395,534	1,164,766	-	-	-	-	2,596,268	87,989	1,216,711,900
1959	-	-	-	17,227	15,695	62,348	75,035	294,456	147,279	148,945	273,702	1,017,608	835,199	-	-	-	2,887,294	291,026	923,697,450
1960	-	-	-	-	11,277	37,662	41,667	148,566	86,929	85,423	145,868	792,967	454,283	1,398,794	-	-	3,203,436	316,142	1,536,050,600
1961	-	-	-	-	-	30,663	33,042	115,850	68,725	67,135	114,642	720,467	348,825	1,271,407	815,724	-	3,586,480	383,044	960,462,000
1962	-	-	-	-	-											932,346	4,079,000	492,520	

* Figures are for entire loans, either to the closing date within the year or in the subsequent year.

Source: Bank of Canada Loans of Government of Canada and loans Guaranteed by The Government of Canada 1947 - 1961.
Canada Year Book, 1961.

February 1962.

APPENDIX C

BANK OF CANADA

CONTENTS PAGE

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BANK OF CANADA

1. ORIGINAL CONCEPTIONS OF THE BANK OF CANADA

1. The previous Royal Commission in Canada, comparable to the one now sitting was the Royal Commission on Banking and Currency in Canada, which, under the Chairmanship of Lord Macmillan, held hearings and made its Report in 1933. It is appropriate to review briefly the scope of its findings which were principally related to:

i. The provisions of the Bank Act, in the light of the forthcoming 1934 revision.

ii. The facilities provided by the Finance Act of 1923.

iii. The advisability (or otherwise) of establishing a central bank with special reference to such a bank's relationship with existing commercial banks, its authority and its functions.

2. The Report related how the Canadian banking system had evolved over a long period of years in such a manner as to suit the peculiar needs of the country. However, with the changes in the economy that had taken place since the Great War, the system was not as satisfactory, relatively, as it had been. Some of these changes included the extensive need for foreign borrowing to finance the country's development, difficulties of making payment of both principal and interest on such debt, and some degree of economic instability caused by the greater dependence of Canada

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upon world economic conditions and prices resulting from an increasing volume of both exports and imports.

3. Internally, there was also a certain lack of flexibility under the terms of the Finance Act, which permitted the banks to obtain advances from the Treasury Board against suitable collateral. (Rates, terms, amounts and margins on such advances were determined by the Board which was comprised of the Minister of Finance and several Cabinet Ministers and was, thus, purely political. The rate at the time of the hearings was 2½ per cent, which became the initial level of the Bank of Canada's discount rate.) Advances were frequent, since they were an important means of the banks maintaining adequate cash ratios in the face of seasonal variations in economic activity and loan demand. Another method was the use of the New York money market where "secondary" reserves could be employed profitably.

4. There was no single banking authority which was detached from commercial banking and yet linked to national business which could endeavour to:

i. Maintain stability in the currency and price level.

ii. Regulate the quantity and flow of credit, seasonal or otherwise.

iii. Regulate exchange fluctuations arising from trade and capital flows.

iv. Co-operate in international monetary affairs with other governments and central banks.

v. Provide impartial and sound advice on internal fiscal policy.

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5. Experience in other countries indicated that a central bank could perform all of these functions. Indeed, since it appeared that no other body could do so, the Commission (by a majority) recommended the establishment of such a bank.

6. The Commission felt that the Bank should be free from political interference (Macmillan Report - paragraph 219. See Exhibit 1.) and, as such, should not be a direct organ of the government. However, the government should have some control over the appointment of the senior officers and directors, all of whom should have experience, skill and integrity in order that the bank could gain the confidence of the Government, the public, the "commercial" banks and its counterparts abroad. The feeling was that the share capital should be subscribed by the general public, with dividends limited to a nominal amount, and any other profits accruing to the government. Other recommendations provided that the new Bank should:

i. Have the sole right of note issue.

ii. Be banker to the Dominion government.

iii. Hold deposits of each of the commercial banks. (The suggested rate was 5 per cent of each bank's deposit liabilities. This was incorporated in amendments to the Bank Act in 1934).

iv. Buy and sell exchange and specified securities, as well as discounting the latter.

v. Issue and manage the public debt of the government.

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On this last function, comments were so limited that one may conclude that the Commission had not visualized the future magnitude of the job and the obvious conflict of interest with monetary policy which was later to materialize. On the other hand, the Report went to considerable length in describing the central bank's other functions, such as exchange dealing and monetary policy, its effects upon the level of economic activity, ways and means by which commercial banks' reserves could be changed, etc. The Commission expressed the view that in Canada, despite the absence of a money market, the banking system would be sufficiently sensitive to changes in the discount rate, open-market and foreign exchange operations, for the central bank to be able to initiate or counteract trends as circumstances required. The Report also pointed out that central bank control over exchange rates was desirable, since fluctuations were often the outcome of credit conditions which could cause short term capital movements, extensive foreign borrowing or lending, and because internal price levels, to the extent they were influenced by changing credit conditions, could vary the volume of international trade. (MacMillan Report - paragraphs 206-210, 218, 229-230. See Exhibit 2). (In passing, and as a matter of interest, the Commission felt that the provision in the Bank Act limiting the rate of interest which the commercial banks could charge should be repealed. In those days, the maximum rate was 7 per cent. The problem is still with us and continues to limit the flexibility of rates charged by the banks).

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[illegible]

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II. POSITION OF THE BANK OF CANADA

7. The provisions of the Act in 1934 which established the Bank of Canada followed quite closely the suggestions of the Macmillan Report. (Bank of Canada Report of the First Annual General Meeting of Shareholders February 25, 1936, page 11. See Exhibit 3). Particularly was this the case, with regard to public ownership and the concept that Bank policy was subject to Parliament. However, several steps including partial and ultimately complete nationalization, more government control over Board appointments and the limiting of the Governor's power of veto over Board decisions, changed the original basic concept of the Bank's position and made it responsible to the government of the day (rather than to parliament) and also set out that the Bank should operate in such a way to implement that government's policy. (Several important statements have been made clarifying this matter, among them, that by the Honourable J.L. Ilsley in 1941, with subsequent remarks by G.F. Towers in 1954 and by J.E. Coyne in 1956. Shortly after his appointment as Governor of the Bank of Canada in 1961, Louis Rasminsky echoed these earlier views. See Exhibit 4). Thus, while it became established that the Bank has freedom in formulating its policy, such policy must be in agreement with that of the Government. In other words, the Bank should have discretion in effecting policy, and the government should have no power to change the methods being used. For this system to function, there are three basic assumptions:

II. POSITION OF THE BANK OF CANADA

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i. The government's policy must be reasonable and sound and not dictated by political aims.

ii. Both the Bank and its Governor must be held in high esteem and their prestige unquestioned, and

iii. There must be the closest of liaison and co-operation between the Government and the Bank.

The unhappy events in 1961 indicate the unfortunate possibilities when any one of these prerequisites is missing. To avoid a repetition of last year's happenings which lowered the prestige of both Canada and its Central Bank, it is suggested that some formal and dignified procedure should be established in the event that there are further disagreements on fiscal or monetary policy between Government and Governor which cannot be resolved. Mr. Rasminsky has suggested the desirability of legislative changes in the Bank of Canada Act to deal with this situation. (Louis Rasminsky, Statement July 31, 1961). This seems to make sense in the light of uncertainties created by the Honourable Donald M. Fleming who stated: "....the government would have no power whatever to terminate the terms of office of the directors or the governor, (House of Commons, February 21, 1961). and in a matter of a few months demanded Governor Coyne's resignation.

III. BANK OF CANADA AND DEBT MANAGEMENT

8. While the original Bank of Canada Act (1934) provided for the Bank to act as the government's

agent "in the payment of interest and principal and generally in respect to management of public debt in Canada", it, in fact, did not become the government's agent until 1938. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1938, page 9. See Exhibit 5) This was accomplished by the Loans and Interest Branch of the Department of Finance being transferred to the Bank and called The Public Debt Division. It was thought at the time that this would ensure closer liaison between the Bank and the Department of Finance and that any conflicts might be more easily resolved. Since the objectives of the Bank, as set out in the preamble to the Bank of Canada Act were "...... to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion......", and these clearly should be the objectives of government, no serious difficulties were envisaged which would cause fiscal policy and its resultant debt management problems to take precedence over the Bank's monetary policy, which, after all, was presumably, also in everyone's best interests. However, years of war and preparedness for was, together with the growth of the welfare state concept have resulted in a most troublesome conflict of interest position for the Bank of Canada in implementing

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its policy, and at the same time having to raise enormous amounts of money for the government. Since it is evident that the Government cannot be denied its cash requirements, the basic objectives of sound monetary policy, even combating inflation, have been, from time to time, sacrificed or delayed. It appears that debt management should revert to the Department of Finance, since in this way not only the Department, but the Cabinet as a whole, may be made more aware of the problems of the fiscal policy being followed.

9. While maintaining that debt management should revert to the Department of Finance, it is relevant to make reference to some of the methods used by the Bank of Canada since it took over the function in 1938. Normally, in public issues, the Bank contacts its list of primary distributors which includes the chartered banks, most of the members of the I.D.A.C., stock brokers and others, and is believed to number between 250 and 300. It may properly be contended that this list is too big and unwieldy to be efficient, and that it should be reduced to those organizations which normally position and make markets in government securities. Other dealers, brokers, or agents could apply for bonds (when they have a demand for them) to this group on a split underwriting fee basis. There follows an outline of some of the methods which have been used to place issues:

i. The Bank has purchased entire issues directly from the Government for cash, e.g. Treasury notes

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1. The Bank has purchased entire issues directly from the Government

during wartime.

ii. The Bank has negotiated on behalf of the government with the chartered banks for the placement, on a formula basis, of il-liquid low-yielding deposit certificates. This was also done in wartime, and again to finance exchange flows around 1950, at which time the banks objected on the grounds that "forced" lending at low interest rates was involved.

iii. The Bank has conducted regular auctions of treasury bills. The Annual Report of the Governor of the Bank for 1956 described the method used. Basically, bills have not been used to any major extent as a method of raising money for the Government, but as a liquidity instrument through which the banks could adjust their reserves with a minimum of difficulty and as an aid in the development of a money market. Increases in 91-day bill outstandings and the issuance of bills with terms of six months, nine months, and one year have taken place as bank assets grew and the money market developed, although some observers now feel that secondary reserves at

the banks contain an element of forced lending. It has been suggested that consideration might be given, in the interests of convenience on smaller orders to alloting amounts up to a specified maximum, in full at the average award, as is the practice in the United States, (R.V. Roosa, Federal Reserve Operations in the Money and Government Securities Markets, page 38. See Exhibit 6) at the weekly auctions.

iv. Occasionally, the Bank has placed with the banks short-term marketable issues, the proceeds of which have tided over the government temporarily, and have been retired from the funds raised through the sale of Canada Savings Bonds, e.g. in 1954 and 1958. Such issues, unlike deposit certificates, have been priced to yield a fair return and have been liquid in the sense that they were saleable.

v. On various occasions, the Bank and the Department of Finance have recruited personnel from primary distributors for exceptionally large operations, such as the National War Finance Committee for Victory

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v. On various occasions, the Bank and the Department of Finance have recruited personnel from primary distributors for exceptionally large operations, such as the National

Loans, the Conversion Loan in 1958, and to some extent, the annual Canada Savings Bond campaigns. As a comment on this last, it appears that so much emphasis has been placed on their sale that difficulty is encountered by dealers in obtaining any material distribution of marketable bonds at retail. This is particularly so, since government bonds have been subjected to such wide price fluctuations. It is suggested that Canada Savings Bonds be used, as was the apparent original intent, as a means of saving, rather than an investment medium for funds already saved. (In his Report to the Minister of Finance for 1946, Mr. Towers stated: "The Canada Savings Bond was designed to incorporate those features of both Victory Bonds and War Savings Certificates most desired by individual savers. The chief purpose of its issue is to facilitate the continuance of regular personal savings habits developed in wartime.")

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value of bonds required), acquisitions of underwritings by the Bank and/or government accounts either for cash or in exchange for maturing or other securities. It is unlikely that the terms, pricing or amount of the offering were discussed with primary distributors, i.e. the organizations and people who would be placing the issue. Even at the time of offering, there have been occasions when the size of an issue has been unknown, due to government or Bank subscriptions which may or may not be re-offered subsequently.

vii. Starting in 1961 and after the government announced that it would stay out of the long market to finance its deficit, there have been some changes in method. The pattern has been about as follows: primary distributors receive an offering of firm bonds (participation determined arbitrarily by the Bank and variable from issue to issue) and usually may order additional bonds, but not more than twice the amount of firm bonds accepted. This is an improvement in that it eliminates some speculation. (i.e. the order is perhaps four times

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the amount which a primary distributor expects to receive, instead of say ten times or more) It also enables the Minister of Finance to continue to announce that his financing was heavily over-subscribed. (It is not recorded whether the Minister, in making his announcements, blushes with becoming modesty or simply sighs with relief). However, it precludes a distributor from getting a materially larger allotment because of the arbitrary participation determined by the Bank, even if orders have been received in excess of such allotment. On the other hand, if a distributor is unable to (or does not, because he thinks terms or pricing are not appropriate, and being ethical, advises his clients against the purchase of the security) obtain sufficient orders to dispose of the allotment, he must accept his firm bonds and subscribe for additional amounts, or run the risk of a reduced participation in future financing, or perhaps having his name deleted from the Bank's list. Another undesirable feature is that primarily, distributors seldom can advise their customers

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properly as to the size of the issue (since the Bank may also be a subscriber and may or may not re-offer) and hence the adequacy of the pricing, from the point of view of supply and demand factors, becomes pure guesswork.

10. There have been four occasions (Sep./61, Nov./61, Jan./62 and Apr./62) when the Bank has acquired the entire amount of a new issue and there has been national advertising thereof, mentioning all terms, including par value, price, and yield in bold-face type and below, in small print, the Bank's acquisition. Subsequently, the Bank has re-offered the bonds to primary distributors at or above the advertised price, either for cash or in exchange for other securities. Primary distributors are thus unable to obtain bonds for clients at the advertised price and make a profit.

11. It should not be necessary to mention that such methods of offering securities would be unlikely to be approved by any Provincial Securities Commission. Such clearance is, of course, unnecessary for government offerings.

12. The above may sound like, but is not intended to be, a condemnation of the Bank of Canada. Rather, it is designed to point out that because of the inadequacies of Canadian fiscal policy, and since it has to be accepted that the Government-of-the-day must have its cash requirements, the Bank, as the debt manager, has become a victim of circumstances and has had to

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resort to any methods available to it to raise the money, in the face of a growing and widespread distrust of marketable Government of Canada long-term bonds as an investment medium.

13. With debt management in the hands of the Department of Finance, there is no reason why the Bank would not continue to co-operate and provide impartial and sound advice but the Department should, in addition, recruit advisory committees from dealers, banks and investing institutions, as is done in the United States. The advice so obtained would reflect the state of capital markets, investor demand for specified term categories of bonds, coupons, yields, method of offering, etc., and would be the most [illegible] and practical available. It may even be considered desirable, in due course, presuming a reasonable fiscal policy, to make use of what has been the most successful method of borrowing by others, i.e. negotiated transactions with dealer syndicates. (SeeExhibit 7). This method is described in detail in Appendix "B" to this brief. Suffice to say here that syndicate members with a liability in the account would, generally speaking, be limited to those organizations which are active in making trading markets and which normally position government securities

IV. BANK OF CANADA FUNCTIONS

(i) General

14. Before outlining some of the tools available to the Bank to put its policy into effect, it might be well to set out some of the problems which such policy is directed to each [illegible]

is to vary the level of the national income and prices, up or down, as conditions indicate, through changes in the chartered banks' cash positions. In order to keep their ratios at the customary level, such variations will tend to induce the banks to change their policies regarding loans and/or investments which, in turn, will change both the cost and availability of credit. Some of these changes may be purely seasonal, (For example, farm and grain loans, loans against Canada Savings Bonds or heavier public demand for cash during holiday periods) and because they tend to reverse themselves in due course they seldom require more than temporary offsetting action by the central bank, and since they are seasonal, they can be anticipated and preparations can be made in advance. There may also be temporary reasons for change which cannot be anticipated and hence require more skill in handling. Among these are substantial inward or outward movements of capital, the government being temporarily out of funds and, perhaps, on occasion in recent years, the results of the Bank being a lender of last resort to banks and money market dealers. Despite the fact that these conditions are only temporary, they may require quick offsetting action by the central bank in order not to create conditions which would be contrary to the monetary policy being pursued at the time, nor to result in disorderly markets for exchange or securities. Finally, there are situations which require more permanent change, such as growth in population and gross national product. In the initial stages of such a trend, the banks can sell securities to

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meet loan demand, and velocity of turnover may increase. However, there are limits to both of these possibilities, and in any case, if carried far enough, they might cause the bond market to be seriously disrupted, making long-term capital borrowing more costly or difficult. Under such circumstances, the Bank must increase the cash reserves of the chartered banks, or foreign borrowing may increase to a point where exchange rates are disrupted. Such changes in monetary policy require fine judgment in order to ensure that productivity, and not price, increases remain dominant. R.V. Roosa in his pamphlet on Federal Reserve Operations, aptly refers to these functions as "the defensive, avoiding mechanical disturbances that could interfere with the smooth functioning of the monetary system, and the dynamic, using the potentialities of control over the reserve base of a fractional reserve banking system to help promote economic growth within a pattern of sustained stability."

(ii) Broadening the Government Securities Market

15. There is a situation which must be improved by a central bank, or the tools at its disposal will have limited impact, and that involves the progressive broadening of the government securities market. To increase the liquidity of the market, over the years, the Bank of Canada has taken the initiative with several steps and substantial progress has been made. Regular treasury bill tenders were inaugurated in 1934, culminating in weekly auctions in 1953, including those for bills with terms longer than three months. During

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its existence, the Bank has always been available to the chartered banks as a lender of last resort but it started, in 1953, to make its discount window available to selected dealers and did a substantial volume of short-term purchase and resale agreement transactions with them. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1953, page 8. See Exhibit 8) In 1954, changes in the Bank Act made possible, for the first time, the real beginnings of a money market (For a description of money market and its functions see Standing Committee on Banking and Commerce, March 16, 1954. See Exhibit 9) in Canada which, through a more liquid bill market and the movement of day-to-day borrowings by dealers, enabled the chartered banks to adjust their cash without dealing directly with the Bank of Canada, and also resulted in non-bank liquidity-conscious investors becoming important holders of bills and other short-term government securities. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1954, pages 11-12. See Exhibit 10). From time to time, the Bank has taken the initiative in causing a reduction in the costs of handling securities, through providing free and simultaneous out-of-town transfers at its agency points, reduced over-certification charges and free movement of day loans within the banking system. (For a detailed analysis see "Broadening the Money Market" by R.M. MacIntoch, Canadian Banker, Autumn 1954). It has also from time to time provided borrowing facilities in securities through sale and repurchase agreements with dealers.

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16. Recently, discussions have been underway, between the Bank of Canada and dealers, regarding a market for bankers' acceptances. Another field to be explored might be the extension of the Bank's lender of last resort facilities to selected dealers, with collateral being Canadas beyond the money market term range of three years. This, with flexible, special, call loans at realistic rates at the chartered banks should in time broaden the market for mid and longer term government bonds.

(iii) Statistical Material

17. The Bank has had success in other directions. For example, its research department makes excellent statistical material available, on a weekly and monthly basis, which not only indicates the direction of central bank activity but shows changing trends in other segments of the economy. This material is invaluable to business and all levels of government in arriving at policy decision. If any criticism may be

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securities due in less than one year as well as publicly held money supply and outstanding Savings Bonds.

V. BANK OF CANADA'S BOARD OF DIRECTORS

18. There is, however, one situation where there appears to be room for improvement. The Macmillan Report stated that it was vital that the management and Board of Directors of the Bank should be filled by persons with the highest degree of experience, skill and integrity. (Macmillan Report - paragraph 227. See Exhibit 12). The government does not seem to have been successful in appointing to the Bank's Board people whose skill or experience appear to qualify them to assist, materially, the Governor and his senior personnel.

19. Working from the reports of the Bank of Canada since its inception, there appears to have been 44 directors (excluding the Governors, the Senior Deputy Governors and the Deputy Ministers of Finance) who have served about 300 man-years. Little information is available on some of them as to their "experience and skill" in financial matters and several did not appear in publications such as "Who's Who in Canada" during their terms as directors. Adding together the man-years served of those who are known to have been, prior to, during, or subsequent to their terms of office, investment dealers, stock brokers, officers or directors of life insurance companies, officers or directors of chartered banks, officers, directors or members of advisory boards of trust companies or economists, the total comes to about 125 (after eliminating duplications in the above-mentioned categories). This is not to

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question the integrity of, nor to belittle the advice the others might have been able to provide to the Governor on such matters as the crop outlook, conditions in certain industries, etc., nor their political value. However, considerably more than one-half of the man-years served by outside directors of the Bank have been served by men whose educational background and business experience appears to have been non-financial. Steps should be taken to remedy this deficiency and in any case the selection of the directors should be based on competence and qualifications and not on racial or religious grounds, place of residence, political affiliation or social position. (For a description of the selection of directors of the Federal Reserve Banks, see Chapter IV of The Federal Reserve System, Purposes and Functions, 1961 edition. The Court of the Bank of England is described in paragraphs 752-753 in the Committee on the Working of the Monetary System Report. The Bank of Canada Act, sections 5-14, indicates management requirements of the Bank). An appropriate Board of Directors would not only be helpful to the senior officers of the Bank in their deliberations, but would enhance the Bank's prestige and possibly create an atmosphere of independence from government on policy matters, because of their recognized intelligence and importance in the business and financial spheres. In the interests of providing the Governor with genuinely useful guidance, it is suggested that a knowledgeable Executive Committee be selected from the Board which should meet frequently, possibly fortnightly, with the

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entire Board meeting at least once a month. In addition, consideration should be given by the Bank to the appointment of advisory committees, such as those suggested for consultation with the Department of Finance.

VI. BANK OF CANADA AND MONETARY POLICY

20. Most of the traditional tools of central banking are available to the Bank of Canada. Some have not been used and others have been, with wide variations of success. Basically, the most important and effective method of central bank control has been the variation of bank reserves (expansion or contraction of the money supply) and this may be accomplished in several ways. This is so-called quantitative control:

(i) Open-market operations

21. Obviously, by buying or selling securities the Bank can affect the deposits and hence the reserve ratios of the chartered banks. (The effects of open-market operations in a factional reserve banking system are described in: (1) The Federal Reserve System, Purposes and Functions, 1961 edition, pages 20-23, and (2) Memoranda and Tables re Bank of Canada given before the Standing Committee on Banking and Commerce, House of Commons 1939, pages 30-34). However, there must be a market for securities for open-market operations to be effective, and the Bank of Canada has taken the initiative in broadening the market with some success, as has been indicated above. In addition to market operations, the Bank can have the same effect on bank reserves at the weekly bill tender by buying

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more or less of the current issue than it holds of the one which co-incidentally matures. Since Bank policy should always be directed at stabilizing the economy, its market operations should not cause disruptions in the government market, (in the sense that violent fluctuations can be avoided) since, it is, of course, the key market and determines the rates at which lesser credits may borrow. (It has become customary for professional investors to establish a notional yield differential between Canada bonds and those of lesser credits. This yield spread varies from time to time for many reasons, but always exists.) The Bank seems consistently, over the years, to have under-estimated the psychological effects of its market operations, which periodically have created excessive speculation and something resembling panic. After all, the Bank is the largest single holder of Canadian government securities. It does not hold them for investment purposes in the sense that most investors, such as chartered banks, insurance companies, pension funds, trust companies or individuals do, i.e. for security, liquidity or income. The Bank's investments are held so that it can change the liquidity or income. The Bank's investments are held so that it can change the liquidity position of others (or as a result of having made such changes). Thus, the effects of its market operations have a tremendous psychological, as well as an actual impact on investors in general, necessitating great deftness and skill in handling if makets are not to be disturbed.

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operated in all term segments of the market. Mr. Towers (Standing Committee on Banking and Commerce, March 18, 1954. See Exhibit 13) explained that trading in longer-term government was designed to broaden the market and he expressed the hope that the Bank could in future play a smaller part, as dealers expanded their operations. Mr. Coyne (Standing Committee on Banking and Commerce, May 15, 1956. See Exhibit 14) pointed out some of the circumstances under which the Bank bought and sold securities. His statement seemed to suggest that the Bank preferred to operate as a result of dealers initiating the selling or buying or if it became necessary to mitigate fluctuations. The Radcliffe Committee's Report (Report of the Committee on the Working of the Monetary System, paragraphs 339, 340, 373. See Exhibit 15) indicated that the Bank of England should operate in longer issues to prevent disorderly markets and if it became desirable to change the liquidity position of the "private sector". Stress is on operations in the bill market, as far as money management is concerned. (Foreign Central Banking: The Instruments of Monetary Policy - Fousek - pages 34-35. See Exhibit 16). W.W. Riefler (Open Market Operations in Long-Term Securities - Federal Reserve Bulletin, November 1958, page 1260. This article should be read in its entirety) described the policy of the Federal Reserve System in its market operations since 1953 and concluded that, since buying or selling bills had the same effect in varying bank cash as trade in any other segment of the market, a bills only (or preferably) policy was justified. Furthermore,

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operating in longer bonds tended to widen their price fluctuations from cycle to cycle and was not justified, except to smooth out disorderly markets. Mr. Riefler's concluding remarks were as follows:

23. "The decision of the Federal Open Market Committee in 1953 to confine open market operations to short-term issues reflected primarily realization that the Government securities market occupied a crucial position in the postwar financial structure and a desire to promote the better technical functioning of that market by minimizing disturbances that might result from the System's own operations. Since the bill sector was very much broader than any other sector of the market, it was clear that such disturbances would be held to a minimum if System operations were confined primarily to bills. The decision of the Committee reflected its confidence that confining operations to the shortest term securities would improve and not impair the market effectiveness of Federal Reserve policy actions.

24. "Basically, the System aids the economy in times of recession by increasing flows of loanable funds and thus helping to finance active demands in the markets for men and materials. This is the ultimate aim of monetary policy at such a time. The achievement of lower interest rates in these circumstances represents a means to an end, not an end in itself. The effective monetary stimulant to the economy in time of recession is an increase in the availability of reserves to the member banks, since such reserves increase by a multiple factor the supply of funds available for loans and investments

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and also help to create a financial environment in which additional credit-worthy enterprises are both tempted and able to borrow. This stimulant can be provided just as effectively by operations in bills as by operations in bonds.

25. "Conversely, the System acts to restrain over-ebullience in the economy when it decreases the rate of credit creation at the commercial banks, thus minimizing excess pressure on the markets for goods and labour. The relief of this pressure, not higher interest rates, long- or short-term, is the object of a policy of restraint. The effect of such restraint in the face of active demands for credit will, of course, take the form of higher interest rates which will help to bring total money demand into line with resource availability. When open market operations are used, it is the lessened availability of bank reserves that effectuates this restraint, not the fact that the security sold in conducting the operation was a long-term bond. Sales of bills are fully as effective in absorbing reserves from the member banks as sales of long-term bonds. More important, they minimize the risk of creating a condition of disorder in the securities market, which might force intervention by the System to support the market at a time when broader economic considerations called for restraint.

26. "The difficult problem for the System in periods of recession or boom is to diagnose the state of the economy and particularly the tempo of the money and capital markets through which policy actions influence

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27. "The difficulty of deciding on the appropriate volume of reserves is magnified when the most relevant indicators of conditions in the long-term capital markets are deflected by transient or short-run responses to the System's own operations. It is minimized when the System is able to effectuate changes in the reserve position of the banks through operations that cause little if any immediate change in expectations, particularly unjustified expectations with respect to long-term yields. The outstanding advantage of open market operations confined to short-term securities is that they meet this criterion." W.C. Martin (Federal Reserve Bulletin, March 1961, page 272. This statement before the Joint Economic Committee should be read in its entirety) confirmed the desirability of the Fed staying in the short market, but in 1961 the outflow of funds in the face of a need for easy credit caused it to adopt a policy of buying longer securities to enlarge bank cash. (operation nudge) Mr. Martin described these operations in January, 1962 (Federal Reserve Bulletin, February 1962, page 131. This statement before the Joint Economic Committee should also be read in its entirety) and implied some concern over the high proportion of trading done by the Fed, particularly in

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28. The framers of the original Bank of Canada Act (1934) apparently did not recognize any great necessity for the Bank's market operations to extend beyond bonds due in less than two years, since its holdings of longer bonds (including provincials) were limited to three times its paid-up capital or $15 million. There have been several amendments to this proviso, but even in 1954, prior to the amendment which removed all such restrictions, holdings of bonds maturing in more than ten years were limited to $75 million. (Holdings of bonds due in over ten years, as of July 31, 1954, were $33 million and as of December 31, 1961, were $1,186 million. Month-end high was $1,351 million in June 1959. A major part of this increase was brought about by the Conversion Loan of 1958). Since treasury bills appear to have been created to be used as a liquidity instrument, the weight of evidence seems to indicate that the Bank of Canada should conduct its open-market operations within the defined money market range (maturities of three years or less), with some emphasis on bills "preferably", excepting during periods of crisis when the orderly market (Committee on the

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Working of the Monetary System Report, paragraph 551, See Exhibit 18, and Federal Reserve Bank of Philadelphia, 1954, "Quest for Stability", pages 18-19. See Exhibit 19.) concept should properly prevail in all term categories.

29. There is a further matter concerning open-market operations in Canada to be considered. While recognizing the necessity for the Bank's Head Office and senior officials being located in Ottawa, trading markets are, in fact, in Toronto and Montreal, and yet the Bank's trading desks in these cities are understaffed and the traders are not given sufficient authority to deal at their discretion. (This problem of liaison seems to have received more recognition in the United States, R.V. Roosa, Federal Reserve Operations, pages 94-95. See Exhibit 20). Not only does this slow down trading, (Inability to deal over the telephone tends to create apprehension and from time to time leads to speculation and larger offerings or bids than exists from business on hand) but the traders have insufficient time to discuss market conditions, expectations, etc. with the dealers in order to get the "feel" of the market and sometimes this is more important than technical projections of probabilities. This could mean that those, in Ottawa, on whom the responsibility for policy decisions rests, may not be close enough to the market to make appropriate judgments. Enlarging the staff of the trading departments in the two principal trading centres seems to be indicated.

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(ii) Operation of Government Accounts

31. Since the Bank of Canada is the Government's banker, it holds in the Receiver General's Account some of the Government's cash, the balance being on deposit with the chartered banks. The proportion held by the Bank may be varied resulting in "draw downs" (decreases in cash) or "re-deposits" (increase in cash) for the chartered banks, both of which alter their cash ratios. The Government has other accounts for which the Bank acts as agent and changes in their holdings may also alter the chartered banks' cash positions. Among these accounts are:

32. The Securities Investment Account, which is used to invest surplus government cash, acquisition of bonds for cancellation, purchase of external-pay bonds when exchange rates are favourable, etc. According to a press release from the office of the Minister of Finance, dated November 8, 1961, certain holdings of government bonds in the account, totalling some $82 million, were cancelled. (A further $37 millions were

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cancelled as of March 31, 1962). This had at the time bullish implications for bond prices, since these bonds could have been sold in the market when the government required cash. Instead, it chose to raise new money in one of its frequent cash borrowings in the short end of the market. Another type of use to which the account has been put took place in February of both 1961 and 1962. On these occasions, the account acquired, temporarily, bonds on a purchase and resale basis from the Bank of Canada, in order to reduce seasonally expanded chartered bank cash without open-market sales which might have disturbed the market and would have had to have been reversed in any case.

33. The Unemployment Insurance Fund which, due to portfolio changes adopted in 1961, is no longer the important factor it once was. (According to a press release from the office of the Minister of Finance, dated October 2, 1961, government bond holdings of the Fund, totalling $201 million, were cancelled and replaced, after repayment of advances from the Treasury, with non-marketable redeemable 3 3/4 per cent bonds). Actually, its operation by the Bank in prior years was often contrary to the Bank's monetary policy, e.g. in periods of recession and unemployment, the Bank's policy would normally be expansionary, and yet to put the Fund in cash to meet its requirements, its holdings of bonds had to be sold. Seasonal factors were also upsetting from time to time.

34. The Purchase Fund (The Purchase Fund was established by the June 20, 1961 Budget, House of

Commons. See Exhibit 21) will likely be used to acquire mid and long-term bonds for cancellation, to influence the yield structure and to stabilize the market. The effect of this fund is similar to that of a sinking fund and, as such, it should prove to be beneficial in time. The periods of budgetary surplus, the use of the Fund can result in retirement of debt in advance of maturity, and the market level of certain term segments can be influenced. However in deficit periods, it adds to the cash borrowing requirements of the government and involves the issuance of additional securities, presumably, in a different term category. Thus, while one part of the market may be supported, another could be adversely effected. It may also be costly. (e.g. As of November 7, 1961, about $61 million of securities held by the Fund were cancelled. The average coupon on these securities was 4.49 per cent and the average term to maturity 18½ years. In September, 1961 the government issued 5-year 3-month 4½'s (4½'s due December 15, 1966) to yield 4.66 per cent. On March 31, 1962, an additional $105 million was cancelled). It is not clear whether bonds acquired and held in the Fund, but not yet cancelled, may be re-offered for sale to the market. It seems apparent that this should not be the case.

35. Evidence seems to indicate that on some occasions the Bank's handling of transactions for these accounts has left something to be desired. Whether the fault lies with the Bank's periodic lack of feel for the market, or the Department of Finance's decisions, or as a result of having to operate, from time to time, in a

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manner contrary to intended monetary policy, is not clear. However, one of the basic fundamentals of successful bond trading is to complete transactions with a minimum amount of disturbance to the market. Such has not always been the case.

N.B. The cancellation, since Autumn 1961, of the marketable bonds in the Securities Investment Fund, the Unemployment Insurance Fund and the Purchase Fund, totalling some $486 million, has been cynically referred to by some observers as "reversing" the 1958 Conversion Loan.

36. Exchange Fund Account. Purchases or sales of exchange, whether they be for the Bank's own account or for the Exchange Fund Account, may tend to contract, or enlarge, chartered bank reserves. However, operations to vary reserves in this manner must be harmonious with policy regarding exchange. Since 1952 (after the Foreign Exchange Control Board was abolished) the Bank of Canada has operated the Fund for the Government and, until recently, has apparently been content to stabilize and maintain an orderly day-to-day trading market, and to minimize wide fluctuations, while letting the dollar find its own level. Canada's holdings of gold and U.S. dollars were $1,860 millions at the end of 1952 and $1,829 millions in 1960, which is indicative of the relatively small over-all effect of the operations. This may have been the result of the terms of Canada's membership in The International Monetary Fund which permitted an unpegged exchange rate, provided the rate was not manipulated. Also, there appears to

manner contrary to intended monetary policy, is not clear. However, one of the basic fundamentals of successful bond trading is to complete transactions with a minimum amount of disturbance in the market. This has not always been the case.

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have been the thought that the flow of foreign funds in or out of Canada could be influenced more readily (and perhaps more economically) by changing government bond yields through monetary policy. (Hence, the close attention paid to yield spreads between Canadian government bonds and those of other countries, particularly the United States). However, in 1961, the government through avowed policy (House of Commons, Budget Speech, June 20, 1961. See Exhibit 22) and substantial operations in the exchange market, definitely influenced, downward, the value of the Canadian dollar in international markets. By the end of 1961, holdings of gold and U.S. dollars had risen to $2,056 millions, an increase of $227 millions during the year, despite a transfer to The International Monetary Fund of $50 million. In the first three months of 1962 however pressures were in the opposite direction and exchange holdings dropped by $347 million. (See Exhibit 23 for comments on exchange policy by W. Earle McLaughlin at the Annual Meeting of the Royal Bank of Canada January 11, 1962. The Honourable Donald M. Fleming denied some of Mr. McLaughlin's allegations in his Budget Speech on April 10, 1962. R.V. Roosa, Under Secretary of the Treasury for Monetary Affairs made some comments on exchange policy in an address before the American Bankers Association in New York City on February 7, 1962). Figures showing holdings of gold and U.S. dollars are released monthly, which seemed adequate prior to 1961. Since then, the swings have been so large that the publication of weekly figures

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would be helpful.

37. In its trading of exchange, the Bank has seldom operated in the futures market, despite the fact that spot transactions may cause a maldistribution of chartered bank cash or require offsetting action. Since there are some seasonal movements of funds internationally which tend to reverse themselves, transactions in futures appear to be a simpler course. Furthermore, international, short-run "hot" money flows on a hedged basis, may be discouraged when such action is deemed to be appropriate, by activity in the futures market designed to alter the relationship to spot rates. In view of our recently altered exchange policy, a full examination of the situation seems to be desirable in order to determine the adequacy (or otherwise) of our gold and U.S. dollar reserves, our position vis-a-vis The International Monetary Fund and the possible effects on our balance of payments.

<u>(iii) Regulation of chartered banks' cash Reserves.</u>

38. Cash reserves have traditionally become considered to be the liquidity cushion enabling a bank to meet its customers' demand for currency and to pay cheques drawn by its depositors, i.e. they ensure adequate liquidity in the banking system. The establishment of a minimum cash ratio for the banks (whether it is varied from time to time, or not) provides the basis from which the central bank's open-market operations may secure their intended results. (Bank Reserves, 1956 printing, page 10. Published by the Federal Reserve Bank of New York.

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See Exhibit 24). This becomes evident, since it is accepted that if a bank experiences difficulties in maintaining its reserves at the required level, it is obviously in an over-extended position and corrective measures such as converting secondary reserves into cash, calling loans, etc., become necessary.

39. Since 1954, the Bank of Canada has had the power of varying the chartered banks legal cash ratio between 8 per cent and 12 per cent of their deposit liabilities, the change not to exceed one percentage point at a time, and on one month's notice. The ratio was set initially at 8 per cent and has not been changed. This compares with a 5 per cent requirement previously (calculated in a different way) and a 10 per cent rule of thumb which had been maintained by the banks for many years. The development of the money market, which provided day loans and greater bill liquidity, enabled the banks to work down from 10 per cent to close to 8 per cent. Mr. Towers felt that the Bank's power to alter the cash ratio should be used only in some emergency, such as when cash increases sharply under peculiar and unavoidable conditions, and when off-setting action is precluded or undesirable. (House of Commons - Standing Committee on Banking and Commerce, March 18 and March 23, 1954. See Exhibit 25).

40. Late in 1955, the Bank induced the chartered banks to "agree to endeavour to maintain", in addition to their cash reserves of 8 per cent, secondary reserves of 7 per cent of deposits, consisting of cash, day loans or treasury bills, (Report of the

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(iv) The Discount Rate

41. As the lender of last resort, a central bank usually establishes a minimum rate at which it will extend short-term advances against suitable collateral, to authorized bodies such as banks, which may require advances to replenish their reserves when some unexpected situation temporarily exhausts cash. Traditionally, the rate has been fixed and changes in it not only signal the expectations and intentions of the

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central bank, but also have led to changes throughout the entire interest rate structure, i.e. credit tends to become cheaper or more costly, as the case may be, as the bank resists deflationary or inflationary pressures. If used in conjunction with appropriate open-market operations, both the availability and cost of credit tend to be altered. As discount rate changes become understood, they have a psychological (as well as an actual) impact on investors, and thus, may tend to lessen the extent of complementary open-market operations (or other actions) necessary by the central bank to attain its intentions. In Canada, little use of the Bank's discounting facilities were made until 1953, when the money market began to function. In 1954, a number of investment dealers were given "lines of credit" with the Bank and began using the discount window quite extensively. Similar, but more official "lines" had been given to the chartered banks many years previously. (For comments on the Federal Reserve's discount window, see pages 24-25, "Federal Reserve Operations in the Money and Government Securities Markets, by R.V. Roosa. See Exhibit 28). Several changes were made in the rate during 1955-1956, but as of November 1, 1956, the Bank announced that the rate would, in future, be permitted to fluctuate each week at a level of 1/4 per cent higher than the weekly average award on three-month treasury bills. (See Exhibit 29 for dates and changes in the discount rate, together with official comments in connection therewith). As a surmise, one may ponder whether the Governor felt that, since his efforts to

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contain credit in 1955-1956 had not been successful, fiscal policy had taken precedence over monetary policy. If so, he may also have felt that a much higher discount rate might draw public attention to this dilemma.

42. The establishment of a "floating" rate appears to have accomplished little -- indeed, it may have hampered the Bank in implementing its policy since it is generally recognized that the simultaneous use of more than one tool by a central bank, e.g. open-market sales in conjunction with an increase in the discount rate, is helpful in attaining the desired result. Recently, too, there have been examples in other countries of the use of changed discount rates to influence the movement of short-term capital between countries where such flows were considered undesirable. Furthermore, the changes in the fixed rate in 1955-1956 were beginning to have effects on other interest rates (i.e. creating flexibility) and the "disturbing" effects to business may have been desirable under existing conditions of extraordinarily high capital investment. There may be some justification for the rate involving a penalty, (The banks are, in effect, penalized by having to pay interest on advances for seven days and yet receive a credit for only five, in maintaining their cash ratios. Both the banks and the dealers may have to pay a rate in excess of the discount rate on renewals of advances, or use of advances on more than one occasion during a calendar month. The same applies on advances in excess of specified lines of credit. In the case of dealers, lines of credit are renewed or changed monthly and such changes may penalize

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44. In all the quantitative controls outlined above, only the chartered banks are directly affected. It would appear that if credit control is to be fully effective, other bodies which accept deposits and make loans (i.e. trust companies, finance companies, etc.) should be subject to equally effective regulations. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 26-27, and also - James Muir - Annual Meetings of The Royal Bank of Canada on January 10, 1957 and January 14, 1960. See Exhibit 31).

(v) Moral Suasion

45. In addition to the above quantitative controls, there is the aspect of qualitative control, or moral suasion (or "open-mouth" policy, as it is sometimes called) which is perhaps the most difficult to describe of the tools available to a central bank. Involved is an endeavour to cause some group, which has some control over the extension of some type of credit, to modify its policy temporarily. Theoretically, there can be no compulsion and the "suasion" has no legal backing. It is the closest the Bank of Canada can come to selectivity in its endeavours to vary the availability of credit.

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47. There is no way of knowing how often, nor when, the three Governors of the Bank of Canada have attempted to use moral suasion. However, some instances have been referred to in the Governors' Annual Reports and others have been commented upon in parliamentary hearings. Some examples may be illuminating, since they illustrate the scope of the attempts and their success, or otherwise.

48. In 1936, the Bank influenced stock exchanges and chartered banks to raise margin requirements on loans against stocks. (Bank of Canada - Second Annual Meeting of Shareholders, February 23, 1937, page 16, and Standing Committee on Banking and Commerce, House of Commons, June 27, 1944, see Exhibit 32).

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50. In 1948, it was suggested to the chartered banks that it was undesirable to finance corporate capital development through bank credit. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1948, pages 7-8. See Exhibit 34).

51. In 1951, the banks agreed to attempt to limit further expansion of bank credit. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1951, page 9. See Exhibit 35). In the same year, the Bank may have asked life insurance companies to limit their purchases of new-issue securities to current income.

52. In 1955, the chartered banks agreed, at the Bank's request, to endeavour to maintain a specified porportion of secondary reserves.

53. Also in 1955, the chartered banks again agreed to limit term lending and to report to the Bank unused commitments for such lending. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1955, pages 17-18. See Exhibit 36).

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57. In 1959, the chartered banks agreed to be most careful in their lending policies and to avoid an increase in loans, if possible. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1959, page 37. See Exhibit 41).

58. In 1960, in his Annual Report and in public addresses, the Governor stressed the concept that high interest rates were necessary in Canada to attract savings. This idea may also have been in his mind when the Bank supported the Conversion Loan in 1958.

59. In August, 1961, the Governor suggested to certain firms (all members of the I.D.A.C.) that it would be undesirable for borrowers to resort to the American market. This directive was rescinded in March, 1962. (Honourable Donald M. Fleming, House of Commons, March 19, 1962. See Exhibit 42).

60. Apparently, many of these suasion efforts were effective, while others, by the admission of the Governor, were not. Several are of special interest. The 1955-1956 inauguration of secondary reserves, which was achieved over the objections of the chartered banks,

56. In 1957, the chartered banks were urged to maintain their rate of N.H.A. mortgage investment and the notional idea of separating savings and commercial deposits was re-introduced. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1957, page 56. See Exhibit 39. [illegible] savings and commercial deposits was mentioned by Mr. Coyne in his 1956 Report, pages 9, 27 and 29. See Exhibit 40).

57. In 1959, the chartered banks agreed to be most careful in their lending policies and to avoid an increase in loans, if possible. (Report of the Governor of the Bank of Canada to the Minister of Finance for 1959, page 37. See Exhibit 41).

58. In 1960, in his Annual Report and in public addresses, the Governor stressed the concept that high interest rates were necessary in Canada to attract savings. This idea may also have been in his mind when the Bank supported the Conversion Loan in 1958.

59. In August, 1961, the Governor suggested to certain firms (all members of the I.D.A.C.) that it would be undesirable for borrowers to resort to the Acceptance market, [illegible] 1962. (Honourable Donald M. Fleming, House of Commons, March 19, 1962. See Exhibit 42).

60. Apparently, many of these suasion efforts were effective, while others, by the admission of the Governor, were not. Several are of special interest. The 1955-1956 inauguration of secondary reserves, which was achieved over the objections of the chartered banks, [illegible]

is still in effect. (One may wonder whether the agreement should not be terminated). Another is the specific reference by both Mr. Towers and Mr. Coyne to chartered banks' savings deposits (as separated from commercial deposits) where, the former limited holdings of Canada bonds against them, and the latter sought to have a proportion invested in mortgages. This leaves open a possibility that, in order to influence liquidity or the yield curve, attempts may be made some time to have, for instance, chartered banks invest a minimum amount of savings deposits in long-term Canada bonds. There are, of course, many variations of this theme which could be played for investing institutions. Aside from the temporary alleviations which moral suasion, when successful, may attain, it may in future be a proving ground, indicating the desirability and practicability, or otherwise, of legislative changes in the Acts respecting the Bank of Canada, the chartered banks, insurance companies, etc. The following matters, which in the past have interested Governors of the Bank, should perhaps be investigated thoroughly with such views in mind.

i. Should the Bank of Canada have the power to vary margin requirements on loans for carrying stocks with both chartered banks and stock exchange member houses.

ii. Should the Bank of Canada have the power to alter the terms (i.e. rates of interest, down payments, periods

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i. Should the Bank of Canada have the power to vary margin requirements on loans for carrying stocks with both chartered banks and stock [illegible]

ii. Should the Bank of Canada have the power to alter the terms (i.e. rates of interest, down payments, periods

of repayment) governing instalment purchases through finance companies, banks, etc.

iii. Should the Bank of Canada have direct power in regulating term lending (including N.H.A. mortgages) by banks. As opposed to public sale of securities, direct term lending by banks for capital expenditures involves the creation of deposits without any offsetting reduction in savings, and hence increases the money supply for as long as the loan is outstanding. This works against flexibility in monetary policy.

iv. Should the Bank of Canada have the power of establishing and varying the cash reserves of trust companies and other "near" banks.

VII. LIMITATIONS OF MONETARY POLICY

61. It is evident that, even when the aims of fiscal and monetary policy are harmonious, there are limitations to the extent of the efficiency of monetary policy in achieving its objectives. This has been recognized by the Macmillan Commission, as well as by the three Bank of Canada Governors, the Chairman of the Board of Governors of the Federal Reserve System, and the Governor of the Bank of England to name a few. (See Exhibit 43, for:

[illegible]
[illegible]
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iv. Should the Bank of Canada have the power of establishing and varying the cash reserves of trust companies [illegible]

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- Macmillan Report - paragraph 235.
- The Standing Committee on Banking and Commerce, Mr. Towers Hearings, 1939 and March 23, 1954.
- Mr. Coyne, on whom the first protracted period of restrictive policy fell, had the most to say. The quoted comments are from his 1956 Report, pages 23-25, and the 1957 Report, pages 17-18. His comments in the 1959 and 1960 Reports are lengthy. See pages 3-10, and 16-23, respectively. His public speeches in these years are also illuminating.
- Mr. Louis Rasminsky - comments made in a press release, dated July 31, 1961, shortly after his appointment as Governor of the Bank of Canada, and in his Report to the Minister of Finance for 1961.
- Federal Reserve Bank of Philadelphia, "Quest for Stability", pages 36 and 52.
- Remarks by Wm. McC. Martin before the Association of Reserve City Bankers, April 11, 1961.
- Remarks by Lord Cobbold, Edinburgh, February, 1961.)

Fundamentally, it can only bring influence to bear in a general way to create an atmosphere which may be conducive to attaining the desired conditions. In other words, it cannot be particular in the sense that it can determine who will get a job and at what level of pay, who can or will borrow money and at what rate, what price an article will command, nor can it influence price levels (nor supply and demand factors) in other countries, which might lead to variations in exports and imports for a country such as Canada.

62. It may be somewhat less evident, but a

central bank may well have conflict from its own functions in attaining its own objectives. In the case of the Bank of Canada, this has been true. For example, in periods when it has been attempting to stimulate the economy by easing credit, it has had to sell bonds for Government accounts such as the Unemployment Insurance Fund. In periods of credit restraint, when the public and the chartered banks have been sellers of government bonds, (sometimes the public redeem their Savings Bonds, and this could reach embarrassing proportions in times of stress) it has had to support the market in order to avoid chaotic conditions. It has also felt compelled to stabilize the bond market before, during, and/or after, government financing. Even in its capacity of lender of last resort, it has had to extend credit temporarily, when it wished to be restrictive. Furthermore, whether ease or restraint is indicated, foreign exchange stabilization or undesirable flows of foreign credit have impinged on the effectiveness of desired policy and, of course, mysterious changes in the velocity of circulation have upset carefully calculated projections. However, the Bank has, generally speaking, been ingenious in its use of offsetting action and/or moral suasion under these and other circumstances. Indeed, discounting the probability which always exists for human error, it is only in recent years when fiscal policy involving continuing deficits and high taxation has taken precedence over monetary policy, that Bank action has become somewhat ineffective. Perhaps, the framers of fiscal policy should examine the oft-quoted preamble to

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the Bank of Canada Act, and govern themselves accordingly. In support of this last statement is the testimony of Mr. Towers before the Standing Committee on Banking and Commerce in 1939. (Memoranda and Tables re Bank of Canada given before the Standing Committee on Banking and Commerce, Chapter V, pages 47-50. Readers will find that little updating is necessary. Mr. Coyne expressed much the same thought in a speech entitled, "Sound Money for Sound Growth" given on March 22, 1960. See Exhibit 44). The following excerpts are still applicable, even though the hearings were held some 23 years ago: "My first comment would be that most advocates of compensatory deficit spending have developed their theory with tacit reference to countries which to a far greater extent than Canada, produce for internal consumption.

63. "Canadian thinking on this problem is inevitably influenced by developments in theory and practice which are taking place in the United States. In that country only about one-twentieth of the national income consists of receipts from goods and services sold abroad. In Canada, the proportion is about one-third. In the United States the problem of achieving full employment and production is mainly one of offsetting or compensating for a reduction in the private demand for durable goods. No one would attempt to deny the existence of a comparable problem in Canada; just because our growth through the later twenties was so rapid the drop in private demand for durable goods has been all the more severe. But in Canada there is superimposed upon this a problem which is perhaps more important and

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certainly more difficult, viz., what to do about a reduction in the demand for goods and services which we sell abroad.

64. "Deficit spending in Canada can have little direct influence upon the course of foreign demand for our products. It can do little to increase domestic consumption of things which we normally export. Again, because of the specialized character of the production for which Canada is suited and equipped, it is unusually difficult to meet a decline in foreign demand by creating domestic demand for new things which this country can produce at a reasonable cost. And the necessary shifts of man-power and equipment might be definitely wasteful if the fall in export demand turned out to have been only of short duration.

65. "There are, therefore, greater limitations upon what compensatory deficit spending can do to offset fluctuations in the Canadian economy than there would be in the case of a more diversified and self-sustaining country. There are also greater dangers involved, as I shall now indicate.

66. "An export economy is in the position of having very little influence over the level at which many of its most important prices are set. It should, therefore, do all it reasonably can to keep its costs flexible and to avoid introducing elements of rigidity through borrowings on fixed terms. Otherwise its competitive position in foreign markets may be adversely affected.

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67. "I have already indicated why I think compensatory spending is likely to have less influence

upon the course of real national income in this country than it would in most others. When large government expenditures are being made and debts are mounting rapidly, there will presumably be relatively less to show for them in the way of an immediate expansion of activity, and the possibility of harmful reactions upon private confidence and spending will be relatively greater."

68. "The apprehension which large government deficits may arouse in the minds of business men and investors, even if it happens to be initially ill-founded, is none the less real. If it is sufficiently strong it tends to bring about its own realization, and is accordingly a factor which warrants most careful consideration when deciding upon fiscal policy.

69. "Another of the main arguments advanced by opponents of a compensatory deficit policy is that it may lead to inflation. In the case of a largely self-contained economy general inflation is unlikely to occur so long as appreciable reserves of productive capacity remain in idleness. In the case of Canada, however, one must also take account of the fact that, under present conditions, there are faily definite limitations upon the range over which domestic production can compete with imports on a cost basis. At least part of the active spending power created by government deficits is likely to increase imports rather than give work to unemployed Canadian men or machines. If the increase in imports is not offset by increased exports (or by borrowing abroad) the external

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value of the Canadian dollar will tend to fall and Canadian prices will tend to rise. In other words, the mere existence in Canada of large amounts of unused capacity does not in itself preclude an inflationary rise in prices."

70. Mr. Towers, in one of his rare public addresses recently stated: (Address, on January 25th, 1962, to the Annual Meeting of The Canada Life Assurance Company, in his capacity as Chairman of the Board) ".....The fact that per capita Gross National Product is less in real terms than it was five years ago, combined with unemployment that has persisted at too high a level, should inspire a most serious and objective search for the reasons behind this unsatisfactory situation.....

71. "In searching for reasons to explain Canada's unsatisfactory economic performance during the last five years, I have mentioned the international over-supply situation confronting many of our major extractive industries and the possibility that the overall burden of taxation and an over-valued currency have had a depressing effect on our affairs. All these things have a bearing on our costs and prices. There is the further possibility -- indeed probability -- that other factors have been operating to push our costs out of line with the rest of the world's. Wage rates are not the only factor in costs of production but they are a very important one, and, if increases in rates are in excess of increases in the productivity of labour, the end result is unemployment, balance of payments difficulties or both......

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72. ".....international conditions have been changing rapidly since 1956 and we have to compete with a number of major countries which, so far at least, appear to have had relative success in keeping their costs of production in line. When this situation gives rise to unused capacity and unemployment in the higher cost countries, attempts to stimulate the economy by public spending and monetary expansion can hardly be regarded as effective long-term solutions."

73. Confirming Mr. Towers' thoughts (but referring to the United States) is the following extract from the highly respected monthly letter of the First National City Bank for November, 1961. ".....there is a "mysterious tag" on government dollars. It says right on our coins and paper money that they are issued by the authority of government. Government spending can be financed by monetary inflation, by use of sovereign powers of money issue. Private spending, under the discipline of income flow and creditworthiness, lacks power to create inflation of truly "explosive" dimensions. Government has unique power to increase spending, and not only through money issue but also through taxation ....It may be observed that an increasing proportion of federal expenditures is in welfare categories where there are no goods produced or services provided as a counterpart for the income given. These payments, however great their social merits, subtract from needs to work, from production, and from flows of goods and services in the markets......Then there is the influence of the extreme rates of taxation, justified by

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the demand of government for more money to spend. Concentrated on working people as a class, they subtract from human effort and from the ability of the private business system -- which puts the goods on the shelves of the stores -- to finance innovations which lower production costs and prices......Although there is a view that rising curves of government spending can stimulate economic growth, the evidence points to the contrary conclusion: over-rapid growth of government spending and taxing obstructs balanced growth of the whole economy. The only time in the past decade that business fixed investment moved up to a higher plateau was in 1956-57, after the 1954 cutbacks in government spending and taxes......Thus, through the tax system used to raise them, government dollars obstruct progress and hence the flows of goods in the market that give real value to money."

74. Observers of the Canadian economic scene will be well aware that text books and tradition throw little light on the problem of continuing budgetary and cash deficits which have become the pattern here, regardless of contraction or expansion in the nation's economy, and despite stifling levels of taxation. Government embarked on an enlarged spending program and broader welfare payments a few years ago, presumably to alleviate unemployment problems. Evidence of success from this policy is inconclusive. In the meantime, the atmosphere which has been created is one of apprehension and concern, hardly the basis for broad economic development. It is urgent that the present

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government (and those to follow) return to fiscal orthodoxy and take steps to move toward cyclically balanced budgets, thus bringing fiscal and monetary policies together harmoniously.

VIII. RECOMMENDATIONS AND SUGGESTIONS

Reference

75. In the above text,recommendations have been made and suggestions advanced which involve further discussion before arriving at definite conclusions. Perhaps, the most important matter discussed is the Canadian Government's fiscal policy which has involved continuing deficits and stifling rates of taxation, but does not appear to have been particularly effective in stimulating the economy to the point where full use can be made of excess plant capacity and labour supply. Such a policy tends to create import demand, put strains on exchange rates, and creates distrust of the intrinsic value of the currency both internally and internationally and may lead, ultimately, to disruption of savings and investment programs. It has made monetary policy and the central bank quite ineffective. It is of prime importance that a more appropriate fiscal policy be developed in Canada.

para. 62-74

Exhibit 44

76. Other recommendations are summarized in the following paragraphs. They appear, more or less, in the order in which they have been

discussed in the text above, and no attempt has been made to present them in order of importance.

Para. 7
Exhibit 4

77. Amendments should be made to the Bank of Canada Act clarifying the Bank's relationship with the Government. Procedure to be followed in the event of the resignation of the Governor, either by his own volition or by request, should be established.

Para. 8-13
Exhibits 5-7

78. In order to eliminate a serious conflict of interest position, debt management should revert to the Department of Finance, from the Bank of Canada. The Department should regularly make use of advisory committees from the dealers and banks. The number of primary distributors used in government financing should be reduced, and include only those who normally position government securities and who regularly make markets.

para. 16
para. 9 (v)

79. In an endeavour to restore confidence in and broaden the mid and long-term segments of the government market, consideration might be given as to whether selected dealers should obtain "lender of last resort" facilities, from the Bank of Canada, against collateral of government bonds maturing in more than three years with special flexible call loan facilities at chartered banks. Less emphasis should be placed on Canada Savings Bonds as a means of saving, rather than a medium for

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para. 16

the investment of funds already saved.

Para. 17
Exhibit 11

80. The Bank of Canada's research department should make available informative pamphlets, which would clarify the Bank's functions, actions and intentions, to complement available material.

Para. 18-19
Exhibit 12

81. The Bank of Canada's Board of Directors should be strengthened, and from time to time, the Bank should make use of advisory committees to be selected from dealers and banks.

Para. 21-28 & 35
Exhibits 13-19

82. The Bank of Canada's open-market operations should be confined to securities in the money market range of three years and under and, when possible, emphasis should be on operations in the bill market. The only exception should be in the event of a disorderly market situation, or when operations are for some Government account.

Para. 29-30
Exhibit 20

83. The Bank of Canada's trading departments in Toronto and Montreal should be enlarged and traders given more authority, in order to facilitate trading and to enable the Bank to have a better feel of the market. Normally, the Bank's trading should be limited to those organizations which regularly make markets in government securities.

84. There should be a complete examination of the Government's exchange policy. Among other things, Canada's position vis-a-vis The International Monetary Fund should be clarified,

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Para. [illegible]
Exhibit [illegible]

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decisions should be reached concerning the adequacy, or otherwise, of our exchange reserves and holdings of gold, and conclusions should be made as to the desirability, or otherwise, of the Canadian dollar being "pegged" in relation to other currencies.

Para. 36-37
Exhibits 22-23

85. The Bank of Canada's discount rate should cease to "float" $\frac{1}{4}$ per cent above weekly treasury bill awards, and become administered. Changes in rate, when deemed necessary, should be accompanied by an explanatory statement by the Governor of the Bank, and on occasion, supported by a statement from the Minister of Finance.

Para. 41-43
Exhibits 28-30

86. Other matters have been mentioned, but further examination and discussion seems to be indicated before recommendations can be made. These suggestions are outlined in the following paragraphs.

87. The Commission might consider whether, if the Department of Finance assumes the debt management function, it would be desirable for dealer syndicates to underwrite direct and/or guaranteed (e.g. CNR) financing.

Para. 13
Exhibit 7

88. The Commission might examine whether chartered bank secondary reserves, which were instituted through moral suasion in 1956, should continue to remain in effect.

Para. 40 & 60
Exhibits 26-27

89. The use of "moral suasion" by the Bank of Canada has been quite extensive, and

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Para. 35-37

Exhibits 22-23

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Paras. 41-43

Exhibits 28-30

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Para. 15

Exhibit 7

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Paras. 40 & 60

Exhibits 26-27

89. The use of "moral suasion" by the Bank of Canada has been quite extensive, and

Para. 44-60

Exhibits 31-42

information gained in its application might be examined to see whether the Bank of Canada should have additional powers to influence such items as stock margins, terms relative to instalment sales, term lending by chartered banks, and reserves for "near" banks.

EXHIBITS

Exhibit 1. Macmillan Report

219. The functions discharged by a central bank being of such vital importance to the economic and financial life of a country, it is perhaps natural to ask whether they could not be adequately performed by some direct organ of government. It has in practice been found that a central bank can give most effective service to the community if it is free from the feat of interference for political ends in operating the delicate mechanism of the national monetary and financial machine ....it has been found that there are preeminent advantages to the state in entrusting the special and highly technical functions of a central bank to a body not subject to the vicissitudes of political life.

Exhibit 2. Macmillan Report

206. ......the central bank,......., should endeavour to regulate credit and currency in the best interests of the economic life of the nation and should so far as possible control and defend the external value of the national monetary unit........from the international point of view, the central bank by wise and timely co-operation with similar institutions in other

information gained in its application might be examined to see whether the Bank of Canada should have additional powers to influence such items as stock margins, terms relative to instalment sales, term lending by chartered banks, and reserves for "near" banks.

Para. 44-60

Exhibits 31-42

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countries, should seek, so far as may lie within the scope of monetary action, to mitigate by its influence fluctuations in the general level of economic activity. These functions do not, of course, exhaust the tasks of a central bank. Within a state, the central bank should, in addition, be a ready source of skilled and impartial financial advice at the disposal of the administration of the day......

207. It is easily possible to expect either too much or too little of central bank action. A central bank is at the same time an instrument and a force. As an instrument it is the means by which the state - which must necessarily retain ultimate sovereignity in matters affecting the currency - can give effect to the national policy. As a force the central bank has certain powers in its keeping which can be used to achieve the ends of national policy. Clearly these powers are of differing efficacy according to the aim of the policy. A central bank cannot be expected to influence the price of a particular commodity. It is even not desirable that a central bank should be specifically charged with any responsibility for the general price level of a country. There are many factors, of varying nature, which combine to influence that level and a central bank, working as it does purely in the monetary sphere, cannot be expected to have complete control, though it may well have a measure of influence. If it attempted to exercise any drastic control it would have to wield powers far beyond those which any body other than the sovereign authority would be entitled to exercise. It is manifest,

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however, that the regulation of the volume of credit is an important factor, in influencing the level of economic activity and therefore of prices and this is one of the cardinal tasks of a central bank......The regulation of the quantity of credit is effected by the action of the central bank on the reserves of the commercial banks. By increasing or diminishing these reserves, or by increasing the cost of securing them, there is set in motion a process of expansion or contraction through the ordinary channels of banking......

208. In the control over the external value of the monetary unit the action of the central bank is also of major importance. This function, indeed, is a logical outcome of that of credit regulation. Whatever additional influences may affect the level of the exchanges, such as short term capital movements, external borrowings and indebtedness, and the income from overseas investments, the long term factor of decisive importance is the credit structure of the country, and no modern state can afford to dispense with the most effective controlling instruments.

209. The services which a central bank may perform in the international sphere are even less easily dispensed with in the modern world than those which it can render within the borders of a state. Whatever changes may occur in the volume of international trade and the comparative positions of various countries, there has never been a time when external financial inter-relationships have assumed more importance than in the last decade......

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210. The precise degree to which the level of economic activity in the world as a whole may be influenced by concerted international monetary action, may be a matter of opinion, but that a common direction in monetary policy may have an important influence in avoiding economic excesses or in stimulating revival is beyond dispute. The co-operation of central banks is beset with many difficulties; its effects are limited or distorted by many non-monetary influences; but if we wish to continue that mutual interchange of goods and services which in the past has stimulated the economic life of all parts of the world, we ought to use all possible means of bringing order into the realm of international relations. In the monetary sphere the germ of such order is to be found in the inter-relations of central banks working to harmonize national policy with the needs of the international situation.

218. To enable it to discharge the essential functions to which we have referred above, modern experience tends to show that certain definite principles should be observed in the constitution of a central bank. Thus, in order that it may regulate credit and currency, it is essential that the central bank should hold a suitable proportion of the cash reserves of the commercial banks. It is essential for the full and satisfactory working of a central bank, that it should have the sole right of issue of legal tender notes; it is essential that the central bank, as the financial adviser of the Government, should in due course hold the various Government accounts and carry out, on behalf of the Government all financial transactions.

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229. .....It may indeed be the case that in the absence of a highly developed money market the control of a central bank in Canada over the financial system could not be as sensitive as that which is exercised, for instance, by the Bank of England in the United Kingdom. The fact, however, that a new institution in Canada would not be able to employ all the instruments of control exercised in an older and financially more highly developed country, seems to us an inadequate reason for omitting to develop such control as could undoubtedly be achieved. The financial system and economic life of Canada are already sufficiently well developed to make the instruments of the discount rate, the purchase and sale of securities, and operations in the foreign exchange market, of sufficient importance in the hands of a well-managed central bank to give it a decisive influence on the credit situation in Canada.

230. Canada is a country with a relatively large volume of external trade and a heavy external indebtedness and is, therefore, especially interested in the international value of her currency. The holding of gold and foreign exchange by the central bank should and could become a factor of the first importance in carrying out the national policy in regard to the external value of the currency. It is no part of the functions of a central bank to monopolize the exchange markets. Here, as in the case of credit control, its function is to impart or counteract a trend as circumstances require, and this task, even from an early date, would be within the capacity of a Canadian central bank.

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Exhibit 3. G.F. Towers' 1st Report

The functions of a central bank are well set forth in the report of the Royal Commission on Banking and Currency in Canada. The chief functions are to endeavour to regulate the volume of credit; to defend the external value of the national monetary unit; to be a ready source of skilled and impartial advice at the disposal of the Government (in the case of Canada, the Dominion and Provincial Governments); and to afford timely co-operations with the central banks of other countries......

Exhibit 4. Hon. J.L. Ilsley --- House of Commons 1941.

.......The Bank of Canada was created by parliament as an autonomous corporation with its stock owned wholly by the government, but with its own management and board of directors appointed by the government. It is an arm of the government, but not a department of the government. The character of the act is such that responsibility for its operations is placed squarely on the shoulders of the governor and the board of directors....... The point which I would like to emphasize is that the responsibility with which the governor and board have been charged by parliament does not in any way relieve the government of the responsibility for the monetary policy being pursued by the Bank, nor in any way militate against public control of monetary policy. The monetary policy which the bank carries out from time to time must be the government's monetary policy, but the government must leave the carrying out of that policy, the choice of ways and means of executing it, to the management of the bank in whose judgment it has

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G.F. Towers -- House of Commons, 1954.

.....The situation is that parliament has placed squarely on the shoulders of the directors and management of the Bank of Canada the responsibility for monetary policy. It would be of no use for us to come before a committee of this kind and say in respect of certain actions which were criticized, we did not like that but the government wanted us to do it......We must and do take full responsibility for everything which we have done......There is no alibi possible for the central bank. On the other hand, there is no alibi possible for the government, because if government said: well, we disagreed with what the central bank did, but parliament has placed the responsibility on them, so what could we

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do? The answer obviously is that the administration of the day, supported by a majority in parliament, can always alter the legislation. In fact, I doubt whether a disagreement would ever necessitate such a thing, because there are various ways and means by which directors and management can be got rid of.....There is a long history behind this thing in central banking.......Just to make sure that nothing I have said conveys a misunderstanding, I would like to add that no central bank, and certainly not the Bank of Canada has any delusions of grandeur or any thought that it has sovereign power that always lies with the administration which commands a majority in Parliament.

J.E. Coyne - House of Commons, 1956.

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I believe that it is essential that the responsibilities in relation to monetary policy should be clarified in the public mind and in the legislation. I do not suggest a precise formula but have in mind two main principles to be established; (1) in the ordinary course of events, the Bank has the responsibility for monetary policy, and (2) if the Government disapproves of the monetary policy being carried out by the Bank it has the right and the responsibility to direct the Bank as to the policy which the Bank is to carry out. The first principle is designed to ensure that the Bank has the degree of independence and responsibility necessary if it is, in the language of the Bank of Canada Act, "to regulate credit and currency in the best interests of the economic life of the nation". To discharge this duty the Bank must be sufficiently independent and responsible in its operations to be able to withstand day-to-day pressures from any source. But in the longer run, if there should develop a serious and persistent conflict between the views of the central bank with regard to monetary policy which,after prolonged and conscientious efforts on both sides, cannot be resolved, the Government should be able formally to instruct the Bank what monetary policy it wishes carried out and the Bank should have the duty to comply with these instructions. The exercise of this authority by Government would

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Exhibit 5. G.F. Towers 1938 Report

Acting under powers conferred by section 23(2) of the Bank of Canada Act, you required the Bank, as from April 1st, 1938, to act as Agent for the Government in the payment of interest and principal and generally in respect to the management of the public debt of Canada. The Public Debt Division of the Bank was constituted for this purpose and on April 1st last the staff of the Loans and Interest Branch of the Department of Finance entered our service. In view of the fact that so much of the work of the former Loans and Interest Branch had been interwoven with work performed by the Bank in its capacity as fiscal agent of the Dominion Government, we believe that the amalgamation will be in the interest of efficiency and economical operation.

Exhibit 6. R.V. Roosa - Federal Reserve Operations

Most of the bidders for small amounts, and many others up to the limit of $200,000 per subscriber, submit noncompetitive tenders which are allotted in full at the average price determined by the accepted competitive tenders (about one sixth to one eighth of the total bill issue each week is currently accounted for by the non-competitive tenders).

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Exhibit 7.

For many years, government-guaranteed C.N.R. financing was handled in this way. When it was taken over by the Bank of Canada in 1951, Mr. Donald Gordon, the Railway's President and formerly a deputy governor of the Bank, expressed his regrets to the Syndicate managers and commended them for their efforts in the past. It may be completely without significance, but in the past three or four years, C.N.R. financing has caused not a little disturbance in the bond market. Mr. J.E. Coyne in a speech entitled, "Credit and Capital" made on December 14, 1959, stated, in part: "......What is perhaps not so widely recognized is that we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, local authorities and business corporations. This is primarily the field of activity of investment dealers. I think there is little doubt that the financial machinery existing in Canada for the placing of new issues of securities on the market is the equal of that of any country in the world and, in proportion to our size, it probably arranges, year in and year out, for the provision of a greater quantity of new capital to those requiring it than is the case in any other country in the world. The results achieved are a reflection of the industry and enterprise and broad national outlook of our investment dealers,....."

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A broad and active demand for short-term government securities is an essential feature of an

effectively functioning money market. The Bank of Canada has always endeavoured to encourage the growth of a short-term market in this country and several further steps in this direction were taken during 1953. The Government of Canada changed its regular offers of treasury bills from a fortnightly to a weekly basis and made available 273-day bills in addition to the usual 91-day bills, both of which developments found favour with the market and increased the demand for and turnover in such securities. In the year just past the Bank of Canada instituted purchase and resale agreements with bond dealers who take a jobbing position in the short-term Government of Canada market. Under these arrangements a dealer may within agreed limits sell treasury bills and short-term Government of Canada bonds to the Bank of Canada with an undertaking to repurchase them over a short period at a predetermined yield to the Bank.

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The term "money market" is widely used but seldom defined and indeed it is not easy to give it a precise definition. The particular sector of the overall financial market which it describes has varied from country to country and from time to time. I think a general definition would include any markets for financial

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assets in which individuals, corporations and financial institutions invest their short-term funds, and in which a certain amount of turnover, or buying and selling, goes on fairly continuously. It is a market for the temporary employment of cash balances.

In Canada, Treasury Bills and other Government of Canada short-term securities are by far the most important categories of assets involved at the present time. Commercial bills and similar instruments which are an important factor in the money market in London, for example, have played and are likely to play a negligible role in Canada. In this country they are held exclusively by banks and there is no trading even between banks in this type of paper. There are a number of other types of securities or assets which may be said to be actually or potentially on the fringes of the money market. For example, the larger provincial governments have a substantial volume of short-term debt outstanding, some of it bearing the name of Treasury Bills. At present there is no trading in these Bills and they are in reality just another form of short-term loan to a province by its banker or bankers. They might, however, develop sufficient tradeability in future to be classed as money market paper. Again, while there is no call loan market in Canada dealing in loans which can be called on really short notice and which are made on an impersonal basis, the type of bank loan whichstockbrokers and investment dealers presently use to finance their inventories might in future develop in the direction of being a true money market type of asset.

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I would not include in my definition of the money market such specialized markets as the stock exchanges and the foreign exchange market owing to the fact that it is not their primary function to provide a liquid form of asset for the investment of short-term balances. For practical purposes then, the Canadian money market consists at the present time of all the buyers and sellers of Treasury Bills and other short-term Government of Canada securities. This will always be the core of theCanadian money market, and only as breadth and volume is developed in this area is it likely that the boundaries of the money market can be extended as widely as in larger and older financial communities.

Now I would like to say a few works about the functions of the money market. In general, I believe that one can say that its function is basically the same as that of any market in a competitive economy whether it deals in financial or physical assets. A good market, by promoting wide competition between sellers and providing wide choices to users, tends to distribute resources where they are used with maximum efficiency. Short-term capital, like any other commodity or service, is likely to be forthcoming in optimum amounts and to be most efficiently used if it is subject to the incentives and disciplines which are provided by a broad market. In Canada, where I think we can look forward to rapid growth and a correspondingly large demand for capital, and where there is considerable scope for Canadian capital to displace external sources of financing, we clearly need to use our own sources of short-term as well

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as long-term capital as effectively as possible. Moreover, the kind of financial machinery needed to provide a good short-term Government securities market will also help to provide better facilities for long-term financing.

Exhibit 10. J.E. Coyne - 1954 Report

The introduction in mid-June of what are known as day-to-day loans was an important development affecting both banking practices and the short-term securities market or "money market". These loans are made by chartered banks against the pledge of treasury bills and Government of Canada bonds maturing within three years. The borrowers are those bond dealers who are prepared to act as jobbers in the short-term market and who have entered into purchase and resale arrangements with the Bank of Canada. Day-to-day loans may be called for payment at any time and the willingness of the Bank of Canada to purchase securities under resale agreements provides an underlying assurance of liquidity.

From January 1953 to June 1954 the Bank of Canada had made a considerable amount of funds available for the financing of dealers' inventories of treasury bills and short-term Government bonds through purchase and resale agreements. The total provided in this way reached a maximum of $73 million in June. Subsequently, day-to-day loans from the chartered banks provided this financing in amounts which, as at the close of business on Wednesdays, varied between a low of $44 million and a high of $135 million, and Bank of Canada facilities were infrequently used.

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In addition to providing a source of funds to finance dealers' inventories of short-term Government securities, day-to-day loans afford a convenient and efficient means whereby the chartered banks may adjust surplus or inadequate cash reserve positions. A bank desiring to replenish its cash reserves may call part or all of its day-to-day loans and present the borrower's cheque through the Clearing House for credit to its account with the Bank of Canada the following day. (A bank can obtain additional cash on the same day by borrowing from the Bank of Canada. In the case of sales of treasury bills, Government of Canada bonds maturing within 5 years, and longer-term Government of Canada bonds, market practices respecting delivery and payment dates have the result that cash is received on the second, third and fourth days, respectively, after the day of the sale.) When the day-to-day loan rate is below the Bank Rate, as has consistently been the case, the borrower whose loan is called has a strong incentive to obtain the funds required to repay the loan from another chartered bank which has surplus cash, rather than from the Bank of Canada under a purchase and resale agreement. One of the effects of the call and the new loan is to transfer deposits at the Bank of Canada from the lending to the calling bank. If the borrower is not successful in obtaining a day-to-day loan from another bank and obtains the funds from the Bank of Canada, the initial effect is to increase the total cash reserves available in the system, as the calling bank receives an addition to its cash without a

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corresponding decrease in any other bank's cash.

Exhibit 11. Radcliffe Report

862. We have one other object in view. This is to strengthen further the research and intelligence side of the Bank's activities and so to assist the Bank to take the lead in promoting and inspiring the objective study of monetary and financial problems. The total volume of research that has been done upon them up to now inside and outside the Bank, appears to us to be insufficient. Moreover the additional information that we suggest should be collected will require analysis by experts skilled in its interpretation and able to sift it so as to provide a more comprehensive view of the way in which the different parts of the financial system are functioning. We have suggested that there are certain areas where we are still too much in the dark and where day-to-day decisions have to be taken with only a limited perception of the relevant factors. An increase in the flow of information will help to remedy this; but it will do so more effectively if the information is made the subject of study and research inside the Bank.

Exhibit 12. Macmillan Report

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Exhibit 13. G.F. Towers - House of Commons, 1954.

As part of our programme to improve and broaden the money market for the benefit of lenders and borrowers and of our financial structure as a whole, the Bank of Canada has been a constant trader in government of Canada securities since we opened our doors in 1935. While the total amount of our holdings of government securities is necessarily determined by considerations of monetary policy, we have endeavoured to help make a market for all government issues and have been very substantial buyers and sellers. In a sense, we perform a jobbing function, holding the inventories which are indispensable to a good market. Investment dealers and banks also operate in this way, although naturally on a smaller scale. We would be glad to see both dealers and banks extend their operations of this character, and have the Bank of Canada play a smaller part, although we would always expect to be a substantial participant in the market.

Exhibit 14. J.E. Coyne - House of Commons, 1956

The central bank does not ordinarily take the initiative to increase or decrease the cash reserves of chartered banks. That is to say, it does not step out and bid for securities if it thinks an increase in cash reserves is desirable, or step out and offer securities in the market, if it thinks a decrease in cash reserves is desirable.

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time. People are making offers to buy or to sell, and the central bank is usually in a position to be able to respond to offers to buy from others rather than to take the initiative to make offers itself.

When there is a need for more money in the country, you probably find some people -- you are certain to find some people -- are selling securities in order to raise cash. If there is a need for more money as indicated by that fact, the central bank can buy some of those securities that are being offered, and thereby provide the cash. It will probably do so at prices which progressively decline as the strength of the selling pressure keeps up, so that you will probably find rising interest rates at a time when there is a demand for more money.

The rise in interest rates, of course, would be much greater if the central bank took no action at all. If we simply stand still interest rates would rise until sufficient buyers were found among the general public to balance the sellers among the general public. So, on the other side of the picture too, when, for a lack of other opportunities to invest, people are interested in buying government securities on an increasing scale the tendency will be for the central bank to provide some of those government securities and sell them, and in that way dampen the fluctuation, which in that case would be a rise in government security prices, and a decline in interest rates. Generally speaking the central bank tries, and I think certainly should try, to foster orderly conditions in markets, and to dampen fluctuations, but not necess-

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Exhibit 15. Radcliffe Report

339. At the heart of its work as the central bank lie the Bank's open market operations in Government debt, including both operations in Treasury Bills in the course of management of the money market and operations in Government bonds for the purpose of influencing the gilt-edged market.

340. The Bank of England operates almost daily in the money market, by buying Treasury Bills from the market (thus putting cash out) or selling Treasury Bills to the market (thus taking cash in), to smooth out shortages and surpluses of funds between one day and another, which arise mainly out of the uneven incidence of payments by and into the Exchequer. The purpose of these operations is that of maintaining an orderly market .... It is in the Government's interest, as the largest borrower in the money market, that the money market should be an orderly market; and that requires that the short-term rate of interest should not fluctuate wildly from day to day or week to week but should be reasonably stable......

373. .....If, for example, the Bank is buying Treasury Bills and selling, in equal amount, short bonds, it is maintaining unchanged the total of the debt but is inducing the private sector to hold the debt with an average maturity date further away: the private sector's total protfolio of financial assets becomes less liquid .....; while if the Bank is selling short bonds or

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Treasury Bills and buying long bonds, the average maturity of the debt is shortened and the private sector is becoming more liquid.

Exhibit 16. P.G. Fousek - Foreign Central Banking

In general, the bank appears to confine its open market operations to short-term securities, although on occasion it intervenes also in the medium and long-term market. Partly because data on changes in the detailed composition of the bank's holdings are not published, it is difficult to determine the importance of the bank's longer term operations. In any event, it seems to be agreed by observers that during recent years the bank has conducted operations in longer term securities only in order to smooth out undue deviations from what the authorities have taken to be the underlying trend of securities prices.

Exhibit 17. Federal Reserve System Report, 1961.

He (Mr. Robertson) also felt that the Committee should return to its previous policy of confining operations to short-term securities. In his view (1) the operation that the Committee had launched in February 1961, including transactions in longer-term securities under the special authorization, had not been successful in raising short-term and lowering long-term rates; (2) had the operation been pushed to the point necessary to achieve what he understood to be these twin goals, its defects would not be obvious; and (3) the deleterious effects of such operations on the market for long-term securities will become more apparent when the Treasury seeks -- as it sometime must -- to extend the maturity

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structure of the Federal debt by attempting to sell long-term securities for cash or in exchange for maturing securities. Furthermore, he believed that while it was possible for the Federal Reserve to acquire longer-term securities without impeding Treasury operations in a period such as 1961, when Treasury financing was chiefly short-term, the sale of such securities would present real problems. In his view such selling action would not only absorb long-term funds from the limited supply but would also aggravate the uncertainties which already plagued the long-term market, weakening its supporting structure and attenuating its appeal to investors. He could not foresee any time, when monetary policy called for absorbing reserves, that the Federal Reserve could sell longer-term securities from its holdings without impairing the ability of the Treasury to lengthen the debt. This,he thought, would be unfortunate, in view of the real need for the Treasury to achieve a more manageable maturity distribution of the public debt. Accordingly, he believed that operations in securities beyond the short-term area should be terminated immediately.

<u>Exhibit 18</u>. Radcliffe Report

551. ......But their attitude has also been strongly influenced by a belief that the long-run interest of the Government as ad ebtor was best served by orderly markets, and that orderly markets implied abstention from disruption of ruling prices just as much as it demanded official intervention to steady a demoralized market.....A deliberate marking-down of the

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Exhibit 19. Quest for Stability

The objective of maintaining an orderly market for Government securities was explained more fully in 1939. The purpose was to protect the market from "violent fluctuations of a speculative, or panicky nature" such as that caused by the outbreak of hostilities in Europe. It was not, however, to "assure any given level of prices or yields for Government securities" nor to prevent "an orderly rise or fall in United States bond prices in response to changes in underlying conditions, "......Recently, there has been another shift of emphasis -- the System adopting the policy that open-market operations should be used for "correcting a disorderly situation in the Government securities market," instead of maintaining an orderly market as formerly. It was felt that the latter policy might result in actions at times which would be in conflict with the over-all goal of helping to maintain economic stability.....

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Exhibit 20. R.V. Roosa - Federal Reserve Operations

Liaison with the Federal Open Market Committee, is, of course, a two-way street, and it is probably as heavily traveled as the path between any two parts of any unit of Government. The inescapable fact the seat of National Government is in Washington, and that primary responsibility for Federal Reserve policy determination must be in the statutory Federal Open Market Committee which meets in Washington, is paralleled by the equally inescapable fact that the centre of the money market and the Government securities market is in New York. The physical trading facilities and the concentration of skilled trading staffs are also there. Consequently, it has been necessary to work out an unusual variety of arrangements for maintaining continuous contact between Washington, New York and the other Reserve Banks to assure by exchange of information and frequent consultation that the detailed execution of policy in New York is in conformity with the policy objectives developed in Washington by the Committee.

Exhibit 21. Hon. D.M. Fleming - House of Commons
June 1961 Budget

The third announcement I wish to make in the field of debt management concerns the establishment of a purchase fund for the orderly retirement of government debt.......The experience of other governments and of private corporations suggests that the existence of such a fund through which purchases of securities are made can have a steadying effect on the market. Over a period of time it should contribute to a reduction

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It has therefore been decided to establish a purchase fund to assist in the management of the public debt. Its initial size will be $100 million, to be used over the next twelve months for the purchase in the market of government of Canada mid and long term securities.

Exhibit 22. Hon. D.M. Fleming - House of Commons, June 1961 Budget.

I now return to the exchange rate. As I have said it is the government's intention that our import surplus of goods and services, which has been running in recent years well over a billion dollars annually, should be reduced substantially, and that this should be brought about through an appropriate adjustment of the exchange rate rather than by direct government controls or subsidies, quotas or tariffs.

No one can say today what the appropriate level of our exchange rate would be when our balance of payments is in a position better suited to our present economic circumstances. But the rate will certainly be lower than it has been of late, and it may well be appropriate for it to move to a significant discount. It will be government policy to facilitate such a movement.

Accordingly the exchange fund will be prepared, as and when necessary, to add substantial amounts to its holdings of United States dollars through purchases in the exchange market. This would have the effect of increasing the foreign exchange reserves available to

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Exhibit 23. W.E. McLaughlin, 1962

From September, 1950, to December 1960, Canada had a true floating exchange rate, in the sense that, aside from smoothing operations through the Exchange Fund Account, its value was determined entirely by demand and supply in the market.

From the "baby budget" of December 20, 1960 to June 20, 1961, this true floating rate was abandoned in favour of what we might call a nudged floating rate. There was no announcement of a change in policy but the Exchange Fund did exert downward pressure on the Canadian dollar through the purchase of U.S. dollars in the open market.

With the final budget, brought down on June 20, 1961, a third variety of floating rate appeared with the announcement that in the Government's view the rate should move to a "significant discount"; but there was no definition of the term "significant" and no clear indication, therefore, of the amount of discount that would be regarded as satisfactory. The uncertainty created by this announcement thinned out both sides of the market and the net result was that the Canadian

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From September, 1950, to December 1960, Canada had a <u>true</u> floating exchange rate, in the sense that, aside from smoothing operations through the Exchange Fund Account, its value was determined entirely by demand and supply in the market.

From the "baby budget" of December 20, 1960 to June 20, 1961, this true floating rate was abandoned in favour of what we might call a <u>nudged</u> floating rate. There was no announcement of a change in policy but the Exchange Fund did exert downward pressure on the Canadian dollar through the purchase of U.S. dollars in the open market.

With the final budget, brought down on June 20, 1961, a third variety of floating rate appeared with the announcement that in the Government's view the rate should move to a "significant discount"; but there was no definition of the term "significant" and no clear indication, therefore, of the amount of discount that would be regarded as satisfactory. The uncertainty created by this announcement thinned out both sides of the market and the net result was that the Canadian

dollar settled to a discount position without initially requiring active intervention by the Exchange Fund.

However, since that time the Government has, through public announcement or use of the Exchange Fund, actively intervened in the market whenever it has chosen to do so, and the nudged floating rate has clearly given way to a manipulated floating rate.

Hon. Donald M. Fleming, House of Commons, April 1962, Budget.

Since 1950 the Government, using the Exchange Fund which was set up in 1935, has operated to restrain and smooth out the more rapid movements of the rate in one direction or the other. At no time, throughout the whole period, have the resources of theExchange Fund been used aggressively, to push the rate in one direction or the other against market forces.....

The Government has not hesitated, and will not hesitate in the future, to deploy a substantial volume of funds, on one side of the market or the other, in order to prevent sudden or erratic movements in our exchange rate.

R.V. Roosa, 1962 Speech.

.....whether a country formally adheres to the gold standard or not, it must have a reserve of some kind of internationally acceptable purchasing power -- either gold or dollars, or possibly pounds sterling, or an equally usable quick line of credit. Whenever its current receipts from sales or the inflow of capital do not equal its current outpayments, it has to draw on this reserve. Consequently, the size and ready usability

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of the reserve -- together with the quick claims against it -- must be watched continually as an indication of changes in each country's external economic strength or weakness.

No country can pursue policies indefinitely which consume its external reserves and draw down its potential credit abroad.

.....a fixed link must be preserved between gold -- the universal monetary metal of timeless acceptability -- and at least one national currency. Since the mid-thirties, the dollar alone has served that function. It is essential that the United States continue freely buying gold, and selling it to the monetary authorities of the world, at the price of $35 per fine ounce....all leading countries (must) maintain fixed (rather than variable) rates of exchange in relation to the dollar, with narrow permissible spreads around the declared par value -- such as the 1 per cent, each way, established by the International Monetary Fund. There must be room for market forces to demonstrate, through small changes within such a band, whether a given currency is presently strengthening or weakening. But there must not be an escape hatch through which one country or another can seek temporary refuge from balance-of-payments disciplines by juggling its own exchange rate -- beggaring its neighbours and disrupting the orderly process of cost and price adjustment among the various products and services that are required for eventual balance-of-payments equilibrium.

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Exhibit 24. Bank Reserves

The preoccupation by the banking community with changes in reserve requirement percentages in recent years has tended to obscure the primary function of the required reserve in the regulation of bank credit and the money supply. This dominant function is to provide a fulcrum on which a flexible monetary policy can get leverage and effectiveness. Since a specific volume of reserves must be held by member banks against their deposit liabilities, the Federal Reserve System, by selling Government securities, can absort banks' excess or marginal reserves, which are available as the basis for credit expansion, or can force member banks to borrow to maintain their required reserves. Thus the System can influence the banks' ability and willingness to extend additional credit. Similarly, by buying Government securities the System can provide the banks with funds with which to repay their indebtedness or to accumulate free reserves, on the basis of which they can make additional loans or investments.

Exhibit 25. G.F. Towers - House of Commons, 1954.

There is a risk that the central bank will use that power as a crutch with which to obviate or perhaps postpone the broader action in the field of monetary policy which would really be appropriate.....But I believe that if it used those powers to supplement its other actions....the power can be very useful, provided it is carefully used and seldom used and never simply as a crutch....I would hope that the power....would only be exercised at a time of sudden need and that as quickly

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as possible after that we would get back to the 8 per cent ratio......I think that the main purpose would be to hold the level in a substantial inflationary spurt without having to rely completely and suddenly on activities in the securities market.

Exhibit 26. J.E. Coyne - 1955 Report

In the course of discussions with the chartered banks in November and December the Bank of Canada urged the adoption of a standard practice regarding the maintenance of a minimum ratio of liquid assets (cash, day-to-day loans and treasury bills) to deposits. The purpose of this suggestion was to establish a working principle of bank operations which would help the central bank in the task of restraining inflationary pressures that might threaten in the future.

The function of a minimum liquid asset ratio is to increase the effectiveness of monetary policy in moderating a too rapid expansion of credit, by bringing the influence of monetary restraint tobear on the lending policies of the banks, on interest rates, and on security markets generally, earlier and more gradually and with greater certainty than would otherwise be the case......

After discussion, the banks have agreed to work to achieve by May 31st, 1956, a minimum liquid asset ratio of 15 per cent which they will endeavour to maintain on a daily average basis from June on. On this basis, fluctuations above or below 15 per cent may occur from day to day or week to week, but for the month as a whole the average would not be below the target ratio......

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Exhibit 27. James Muir - 1958

With the inception of a tighter money policy some two years ago, it was arranged between the Bank of Canada and the chartered banks that the latter would maintain a secondary reserve of 7 per cent of Canadian deposit liabilities in day-to-day loans and Government Treasury Bills. The maintenance of secondary reserves by the banks was nothing new; the innovation lay in stating reserve requirements in terms of a positive objective.

What we have now to avoid is that this objective should become an inflexible figure. An inflexible reserve is not in fact a reserve at all but a compulsory investment.

Exhibit 28. R.V. Roosa - Federal Reserve Operations

The use of the "discount window" by member banks is, of course, a privilege that is not to be abused or overused, since no bank should expect to exist on permanently borrowed capital beyond the equity supplied by its own shareholders.....the "discount window" is not a loophole in the Federal Reserve System's credit control apparatus. It is instead a safety valve, enabling individual banks to restore their reserves to the required level when unforeseen losses of funds have created reserve deficiencies, ...In effect, borrowing gives the affected bank time both to determine whether or not fundamental changes will have to be made in its own portfolio and to carry out in a reasonably orderly manner any such changes that prove to be necessary......

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is always at the initiative of the banks themselves, and which is always granted initially (perhaps with rate exceptions, in circumstances that would have been already discussed with an offending bank), there is an entirely different method of providing funds which the Federal Reserve also may use in smoothing the gyrations of the money market -- that is, the repurchase agreement with non-bank Government securities dealers. Under a repurchase agreement, the Federal Reserve acquires securities from a dealer against payment, under a contract which binds the dealer to repurchase the same securities at the same price on or before a stipulated final date, and to pay the Federal Reserve a specified rate of interest over a period that it holds the securities.

Exhibit 29. Bank of Canada Discount Rate Changes

Date	Rate	Comment
March 11,1935	2½%	Our bank rate was established at 2½ per cent and remains unchanged. The figure is the same as that which was being charged for advances under the Finance Act, prior to the establishment of the Bank of Canada, and it remains the charge which we would ordinarily make to the banks for advances. It is quite out of touch with Treasury Bill rates, but this fact is not at present of any particular significance. When money is in plentiful supply, the need for loans or rediscount facilities seldom arises. It is in times of greater stringency that accommodation from the

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central bank is essential. A central bank must be what is known as the lender of last resort, which implies that in times of real need its rediscounting and lending facilities will be freely accorded.

Reference - First Annual Meeting of the Shareholders of the Bank of Canada, February 25, 1936, page 16.

February 7, 1944

1½% At a meeting of the Board of Directors on February 7th, 1944, it was decided to reduce the Bank Rate to 1½ per cent, effective February 8th, from the 2½ per cent level which had been maintained since the Bank's establishment in 1935. During the intervening period, there had been a considerable reduction in interest rates on short-term securities, and the bank rate was somewhat out of line with the current market. However, this was not a matter of great importance because the lending facilities of the Bank have been required on few occasions and for rather small amounts. The change to a 1½ per cent rate does not mean that the Bank expects its credit facilities to be needed on a much greater scale in the future than in the past. Nor does it mean that under the existing war conditions there is any less need for people to save. The utmost effort to maintain and increase our saving is still necessary, and the first and foremost concern of financial policy must be with winning the

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war. The stage has now come, however, when many are also having to give thought to the economic problems which will arise after the war.

One factor which will affect decisions is the prospective cost of borrowing. It therefore seems appropriate that the Bank should, by reducing its Rate, signify its intention to continue the kind of monetary policy which has brought about the current level of interest rates. A policy aimed at higher interest rates would only become intelligible if, after war shortages are over, consumers' expenditure and capital development were to proceed at a rate which would overstrain our productive capacity. I see no prospect of such a situation arising in a form which would call for a policy of raising interest rates.

Reference - Report of the Governor of the Bank of Canada to the Minister of Finance for 1943, pages 4-5.

October 17, 1950 — 2% Effective October 17th Bank Rate was increased from 1½ per cent to 2 per cent per annum. The 1½ per cent rate had been in effect from February 8th, 1944, prior to which date the rate had been 2½ per cent. The Bank issued a press release on October 16th containing the following statement: "At the time the reduction in Bank Rate took place in 1944, the Bank expressed the view that it did not then see any

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Reference - Report of the Governor of the Bank of Canada to the Minister of Finance for 1950, pages 12-13.

February 14, 1955 — 1½% The Bank of Canada announced at the close of business today a reduction in "Bank Rate" to 1½ per cent from the previous level of 2½ per cent which was established in October 1950. The Bank Rate is the minimum rate at which the central bank will lend for short periods to the chartered banks and the money market on the security of Treasury Bills and short-term Government bonds. Yields on these securities have declined materially over the past year and a half and Bank Rate at the old level had ceased to bear a reasonable relationship to other short-term interest rates.

In the past, Bank Rate has been changed infrequently in Canada and little use has been made of the Bank's facilities. The growth in the breadth and scale of activity in the short-term money market over the past two years has made

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it desirable that the Bank rate to be made more flexible and bear a closer (though not fixed) relation to other short-term interest rates. The present adjustment will help to make Bank Rate a more significant factor in the money market and facilitate its more flexible use in the future as circumstances may require. While the structure of short-term interest rates, including Bank Rate, provides an index of monetary conditions, it does not follow that every change in Bank Rate or in the level of other short rates necessarily indicates a change in general economic conditions.

Reference - Statement from Bank of Canada, dated February 14, 1955.

August 5, 1955	2%	
October 12,1955	$2\frac{1}{4}$%	
November 18,1955	2 3/4%	
April 4, 1956	3%	
August 9, 1956	$3\frac{1}{4}$%	
October 17,1956	$3\frac{1}{2}$%	
November 1,1956	Floating Rate	Since the Bank of Canada acts in the role of lender of last resort, its lending rate should not be as low as the interest rate on the most liquid form of security in the market, namely treasury bills... Prior to November 1st, 1956 the Bank had follow-

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ed the practice of keeping its lending rate above the treasury bill rate by raising the Bank Rate at intervals of some months whenever the treasury bill rate approached or temporarily exceeded the previous level of the Bank Rate. In 1956 the Bank Rate was increased from 2 3/4 per cent to 3 per cent on April 4th, to 3¼ per cent on August 9th and to 3½ per cent on October 17th. This procedure gave rise to some misunderstanding; in some quarters it was apparently thought that the central bank was setting or fixing or controlling interest rates of all kinds by its action in changing and publishing its own minimum lending rate.

The simplest method of ensuring that the Bank Rate will always be higher than the treasury bill rate is to keep it at some specified and published margin above the treasury bill rate, whatever the latter may be. This method was adopted on November 1st when the Bank announced that it would thereafter until further notice adjust its lending rate once a week in order to maintain it at a level of 1/4 of 1 per cent above the average rate on treasury bills at the most recent tender or auction of treasury bills. At the close of the year the Bank Rate was 3.92 per cent.

Another reason for adopting the new method of determining the Bank Rate was that weekly changes in the treasury bill rate are relatively

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Another reason for adopting the new method of determining the Bank Rate was that weekly changes in the treasury bill rate are relatively

small in either direction and the fact that such changes occur weekly has become well understood. On the other hand, unexpected, unpredictable, infrequent and relatively large changes in the Bank's lending rate under the previous system were known to have a disturbing effect on business in general and on all persons who might be contemplating the making of investments or entering into business arrangements involving credit and rates of interest. No difficulties of this sort have been reported since the adoption of the new system.

Reference - Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 45-46.

In his Report for 1960, Mr. Coyne, in an apparent effort to justify the continuance of the floating rate, traced the history of the Bank's discount rate and compared its use with the use made of such facilities in the United Kingdom and the United States. Pages 58-64.

Exhibit 30. James Muir - 1958

......I can add only that I wish Bank Rate were a more positive thing -- that it should assume the more manly role of being a leader rather than create the impression of meekly following money market operations.

James Muir, 1960.

.......there is need for improved communication between the Bank of Canada and the chartered banks. Of course, communication must be a two-way street. I have long deplored the passing of bank rate in Canada from the

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of communication in this sense to a mere shadow, floating $\frac{1}{4}$ per cent above the market rate for three month Treasury Bills. However, we must respect the Bank of Canada's evident determination to avoid even the possibility of a modest departure from the collective judgment of the free market.

Fortunately, the chartered banks are not yet reduced to the interpreting of obscure signs and portents or the reading of entrails to divine Bank of Canada policy; although a cynic might suggest that we have progressed very little beyond the plight of the noble savage watching as in olden times for the occasional smoke signal from the haughty Ottawas.

G. Arnold Hart - 1960

The need for what might be termed a lead from the central monetary authorities is all the more apparent by reason of the curious method by which the central bank's rediscount rate is determined. In other money markets a change in the rediscount rate is rightly regarded as a matter of the highest significance. It traditionally represents a means by which central bank indicates to the market its views as to whether credit should become more stringent or more plentiful. In Canada, by contrast, the rediscount rate, since November 1956, has been determined weekly by the expedient of adding a quarter of one per cent to the average weekly tender rate for three-month treasury bills. In other words, what in other money markets is a major monetary indicator that is changed infrequently and only in the light of official reappraisal of fundamental conditions, is in Canada like

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J. Douglas Gibson - 1960

.....A clearer indication from the central bank to the business community as to the direction of its monetary thinking would therefore be helpful in promoting more stable financial conditions and perhaps in encouraging a level of long-term interest rates less restrictive to the potential borrower.

It is often said that we should return to the traditional system of having the central bank formally set the Bank Rate from time to time. The automatic system has been tried and, whatever its merits, it rules out the possibility of giving any signal or direction to the financial community. I think on balance it might be useful to restore the Bank Rate signal.....

Quest for Stability

.......Changes in the discount rate, as a symbol of Federal Reserve policy, may have important psychological effects. They reflect the recognition by a group of well-informed and responsible officials of a change in the credit situation. An increase in the rate indicates official concern over credit expansion and points toward a tighter credit policy. A decrease may be regarded as an indication of an easier credit policy and possibly lower interest rates.....

<u>Exhibit 31</u> - J.E. Coyne - 1956 Report

Finance companies carry on an operation which is in all essentials banking, but are not restrained by changes in monetary conditions. They are able to compete for deposits through the sale of short-term paper in the

a cork that bobs around from week to week....

J. Douglas Gibson - 1960

.....A clearer indication from the central bank to the business community as to the direction of its monetary thinking would therefore be helpful in promoting more stable financial conditions and perhaps in encouraging a level of long-term interest rates less restrictive to the potential borrower.

It is often said that we should return to the traditional system of having the central bank formally set the Bank Rate from time to time. The automatic system has been tried and whatever its merits it rules out the possibility of giving any signal or direction to the financial community. I think on balance it might be useful to restore the Bank Rate signal.....

Quest for Stability

.......Changes in the discount rate, as a symbol of Federal Reserve policy, may have important psychological effects. They reflect the recognition by a group of well-informed and responsible officials of a change in the credit situation. An increase in the rate indicates official concern over credit expansion and points toward a tighter credit policy. A decrease may be regarded as an indication of an easier credit policy and possibly lower interest rates.....

Exhibit 31 - J.E. Coyne - 1956 Report

Finance companies carry on an operation which is in all essentials banking, but are not restrained by changes in monetary conditions. They are able to compete for deposits through the sale of short-term paper in the

money market and to raise funds in securities markets, paying any necessary rate of interest for these purposes, for increased interest costs do not appear to deter consumer borrowing. Banks may not charge more than 6 per cent interest on loans. Finance companies are not limited in this respect and their rates of interest or carrying charges range from 1 per cent to 2 per cent per month, i.e. 12 per cent to 24 per cent per year, or more. Some of the companies are subsidiaries of large foreign corporations and can obtain funds directly from them. Finance companies are not required to maintain reserves nor are they subject to regulation in the way that banks, life insurance companies and some other investment institutions are.

.....While consumer credit may be a useful adjunct of modern merchandising, large fluctuations in the volume of such credit make it a de-stabilizing factor working against the stabilizing efforts of fiscal and monetary policy. The existence of what amounts to a rival banking system, competing for deposits and short-term funds in order to make short-term loans to finance consumption.....without supervision or regulation, and out of step with the trend of credit policy in the regular banking system, can be a definite handicap to monetary policy during a boom.....

James Muir - 1957.

The second source of additional inflationary pressure is the result of the growth of non-bank respositories of funds. Some of these are subject to governmental regulation or control, but not by our

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The second source of additional inflationary pressure is the result of the growth of non-bank respositories of funds. Some of these are subject to governmental regulation or control, but not by our

monetary authorities and not for purposes appropriate to monetary policy.

The curtailment of bank credit may have little direct effect on the supply of funds from non-bank sources. Even those institutions, such as the finance companies, with traditionally large bank loans, have alternative sources of funds, and these sources become more significant as the non-bank sector of the business community increases in importance as a repository of liquid funds.

It would seem therefore, to be at least open to doubt whether the present facilities and techniques available to our monetary authorities are sufficiently wide in scope to deal with present-day problems of credit control. The classical weapon -- upward movement of interest rates, largely through commercial banks -- may by itself prove an impotent policy. The "bite" applied can sieze upon an insufficiently large segment of the whole money and credit system. Over the years, such an abundance of other forms of credit creation has arisen that the over-all supply of credit may move in a direction completely opposite to that which official monetary policy is trying to induce. It may be taking too positive a view of a distant scene, but it would at least appear that, in order to be fair and in order to achieve the best results, our monetary and credit control may have to embrace a wider area of our financial world than it now does.

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The implication of this ambiguity for policy is

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James Muir - 1950.

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simply this, that monetary control is inhibited and may at times be ineffective, as well as inequitable, in controlling the money supply in this broader sense. Rather than extend the range of specific government regulation, it might be worthwhile to require that these lenders (who, in effect, do a banking business so far as the total supply of money and credit is concerned) should, like the chartered banks, be subject to appropriate cash, or other, reserve requirements.

Exhibit 32. G.F. Towers - 1936 Report.

I believe that it was a wise move on the part of the leading Canadian Stock Exchanges to raise margin requirements during 1936, and I feel sure that they will have the co-operation of other lenders if -- as may well be the case -- further increases become necessary.

G.F. Towers - House of Commons, 1944

I think it was in 1936 -- although I am speaking from memory -- that it seemed to us that the very active and rising stock markets which were in existence at that time were tending to go a shade too far in their use of increased credit. So that we did speak to the committees of the stock exchanges and also to the banks, and suggested that the percentage of margin requirements should be raised. That was a matter of suggestion and persuasion; but it did not take anything very much in that way, because I think that the banks and the committees of the stock exchanges agreed that would be a wise move, and it was done.

Exhibit 33. G.F. Towers - 1946 Report

In the case of Canada where the chartered banks

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Exhibit 33. G.F. Towers - 1946 Report

In the case of Canada where the chartered banks

carry on both savings and commercial banking under one roof, an agreement was made with the government early in 1946 recognizing the link between savings deposits and holdings of market issues of government securities. The banks agreed that their investments in Dominion government direct and guaranteed issues (other than Treasury Bills, Deposit Certificates and Treasury Notes) would not average more than 90 per cent of the amount of their Canadian personal savings deposits. The banks also agreed that their earnings on such bonds should not exceed the cost of operating their savings business by more than a moderate profit margin.

Exhibit 34. G.F. Towers - 1948 Report.

Before 1945, chartered banks seldom financed business capital expenditures through medium or long term loans. In the post-war period, however, the chartered banks extended a substantial amount of capital assistance to business through the purchase of corporate securities, particularly in 1947. Early in 1948 it became apparent that business intended to make even larger capital expenditures and that this might mean increased pressure on available labour and materials. Accordingly, the Bank in February 1948 suggested to the chartered banks that conditions prevailing at that time made it undesirable for capital expenditures to be financed through expansion of bank credit. We suggested that it would be preferable for borrowers to obtain such funds by the sale of securities to the public, except in the case of those borrowers, mainly small concerns, for whom a public issue would not be an appropriate means of financing.

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Exhibit 35. G.F. Towers - 1951 Report

Meetings with representatives of the chartered banks during February 1951 to discuss the situation found the banks in agreement with the suggestion that further expansion in total bank credit was undesirable under existing conditions. To prevent such a development the banks undertook a more rigorous scrutiny of applications for credit with a view to curtailing advances for less essential purposes and to encourage borrowers to go to the security market or elsewhere for their capital requirements.

Exhibit 36. J.E. Coyne - 1955 Report.

Historically, in their role as commercial bankers, the chartered banks have not made a practice of term lending, that is, making loans to business corporations where the time of payment is deferred beyond that of ordinary bank loans, or purchasing a security issue negotiated directly with the customer as distinct from buying a publicly issued security in the market. In recent years, however, term lending has appeared in three distinct periods, with little such lending taking place in the intervals between. On each occasion the Bank of Canada has felt it necessary to propose and the banks have agreed to a cessation of most forms of term lending. The first occasion was from January 1948 to February 1949. The second occasion was from February 1951 to May 1952, this time in conjunction with a general ceiling on all forms of bank loans. The third such occasion came during 1955.

In September I discussed with the banks the

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rapid increase which appeared to be taking place in their term lending to corporations. In order that both the Bank of Canada and the chartered banks would be in a better position to appraise the situation, a weekly report from each bank of the amount of its forward commitments in respect of term lending....was instituted..... At the end of November it was agreed that all banks would in general cease making new commitments for term lending.

The agreement to refrain from term lending, as defined, does not prevent the banks from extending temporary credit to their customers for capital development programmes......

Exhibit 37. J.E. Coyne - 1956 Report

Another step taken by the Bank with a view to reducing if possible outstanding anomalies was in connection with stock market credit required for margin trading. Increases in the amount of credit used for this purpose in the United States had prompted the Federal Reserve Board to exercise its powers to increase margin requirements from the previous level of 50 per cent, to 60 per cent in January 1955 and 70 per cent in April 1955, a requirement which is still in force. As a result, the total volume of credit used for stock market trading did not significantly increase in the United States after April 1955. In Canada, on the other hand, the volume of credit so used had approximately doubled between March 1955 and July 1956. The general margin requirement according to the rules of the stock exchanges in Canada is 50 per cent. The Bank of Canada has no power to impose or alter margin requirements. The Bank did, however, have

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Exhibit 38. J.E. Coyne - 1956 Report

Again, it became apparent during 1956 that the volume of consumer credit, particularly in the form of instalment finance, was expanding more rapidly than other forms of credit, such as ordinary bank loans, and was continuing to expand rapidly in the latter part of the year after bank credit had more or less levelled off. The Bank held discussions with representatives of the major instalment finance companies with a view to seeing whether some voluntary agreement could be reached among the leaders of the industry to prevent any further significant increase in the total volume of credit of this character. It turned out that agreement of all concerned could not be reached......The Bank also had an informal discussion with representatives of the major department stores and chain stores engaged in selling consumers' durable goods on credit, many of which do their own financing but also depend on occasion upon funds provided by the instalment finance companies. These representatives expressed the view that in their business credit terms had not been relaxed, and no agreement was reached with respect to restraining further increase in the volume of consumer credit extended through these outlets......

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In the early months of 1957 the chartered banks had virtually withdrawn from the field of insured residential mortgage lending.....

In discussing this situation with the chartered banks I expressed the view that they should maintain continuity in mortgage lending as an important field of investment for savings entrusted to them. At a meeting in March the banks agreed to resume operations in this field on much the same scale as in 1956......Bank of Canada indicated that the total resources of the banks as a group could be expected to increase during 1957 by an amount at least great enough to take care of their disbursements on mortgage loans in that year, so that it would not be necessary for the banks to dispose of other assets in order to maintain a flow of funds for insured housing loans.

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Long term investments made from and limited by funds accruing from the growth of savings deposits are in quite a different category from credit expansion in the form of current or demand loans to businesses and individuals, which may reach excessive proportions....the financing of such credit expansion through the use of funds arising from savings deposits, both directly and from the sale of Government bonds in which savings deposits previously received had been invested, has been one of the less predictable and less stable features of monetary developments over the past two years......In Canada this has been more noticeable perhaps than elsewhere because of

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the extent to which commercial banking functions and savings banking functions are intermingled in the operations of the chartered banks. Over 80 per cent of total personal savings deposits in Canada are held with the chartered banks, and the pattern of investment of such deposits has varied widely at different times. The banks may under conditions of inflationary pressure expand their commercial and general loans and other forms of short-term credit from such funds, which in other times would go into long-term investments....the availability for commercial and general loans of funds that can be obtained by the banks by selling in large volume the Government securities in which a considerable proportion of their savings deposits had previously been invested. By this means, the greater part of the resources of the banks' savings departments have been available as required from time to time to augment the other resources of the banks' commercial banking departments when the demand for commercial loans has been particularly great......

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By April the banks were becoming concerned about the rate of growth in their loans. On May 14 following a series of meetings the President of the Canadian Bankers' Association issued a public statement saying that the banks intended to exercise the utmost care in the handling of their credit facilities, in order to avoid any significant further increase in the overall total of bank loans, and that within these limitations, a special attempt would be made to look after the

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essential credit needs of small borrowers.

At the annual meeting of the Canadian Bankers' Association on June 12, 1959, the President in his published address re-affirmed the statement of May 14.

Nevertheless, the banks experienced great difficulty in bringing their loans under control.....

Exhibit 42. Hon. D.M. Fleming - House of Commons, 1962.

.....There has been no change in policy. After Mr. Rasminsky had taken over his duties last summer as governor of the bank he met with representatives of a number of leading investment houses in Canada and proposed to them that for the time being it would be desirable that they should not undertake financing in the United States market, with the opportunities that existed in Canada for that purpose. It was expected that this would be for a temporary period and, in view of the governor, that period has now been concluded. All he did was to inform the financial houses that he would no longer ask them, as I am informed, to refrain from doing financing in the United States market if they thought it proper to do so, but he has not suggested to them that they should do so.

Exhibit 43. Macmillan Report

235. We are now in a position to sum up our general views on the question of a central banking institution for Canada. We should perhaps sound a note of warning as to the degree to which such an institution could fulfil all the expectations that the public mind might attach to it. A central bank could not cure all the economic ills of Canada; it would not be a source of unlimited credit for all borrowers on all occasions;

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No amount of monetary expansion can hope to restore a high level of real national income in Canada during a period when there is a major decline....in the demand for our goods in foreign markets....it cannot create an important demand for goods which we would normally export nor can it....create new industries to absorb man-power.....from depressed export industries....

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There are limits to the role of monetary policy in any free economy, and this applies with particular

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There are limits to the role of monetary policy in any free economy, and this applies with particular

force to a country so dependent upon foreign trade as Canada. We must view the changing economic conditions in our economy in the context of the vicissitudes of our great trading partners.....Many of the investment decisions with regard to resource development in Canada are made by non-resident investors. Much depends on the degree of business optimism outside our borders as well as within Canada.....But this does not absolve us from the necessity of having a monetary policy of our own, in order to minimize the adverse effects of developments abroad and to inhibit the growth of unfavourable fluctuations of domestic origin.

Louis Rasminsky - July 31, 1961, Statement

Too much reliance on monetary policy either as a restraining or a stimulating factor would, however, lead to unsatisfactory self-defeating results. If one were to try to control the excesses of a boom period through monetary policy without adequate support from appropriate fiscal, debt management and other economic policies of Government, one would run the risk of creating great strains in the financial system in the form of intolerably high interest rates and disorganization in capital markets. On the other hand, the precise part that monetary policy can appropriately play in stimulating economic expansion is necessarily influenced by the part being played by the concurrent fiscal, debt management and other economic policies of Government. The central bank has an important part to play in influencing the trend of interest rates in a direction appropriate to the economic situation. But an attempt on its part to impose a level

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Louis Rasminsky - July 31, 1961, Statement

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of interest rates which appeared unrealistic to the market would impair confidence in the value of the currency and present a serious obstacle to the orderly flow of funds through the capital market.

Louis Rasminsky - 1961 Report

Good economic performance depends both on financial policies and on the basic elements of economic efficiency -- a well-trained, energetic and adaptable working population, dynamic business leadership, the imaginative application of modern technology, good marketing practices, and perhaps above all the determination to be competitive. These basic factors need an environment of appropriate financial policies if they are to make their maximum contribution to the achievement of our economic goals. But if the basic factors themselves are missing, their absence cannot be adequately compensated by variations in the cost and availability of credit, or by variations in the foreign exchange rate, or indeed by any kind of purely financial management.

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......The Federal Rserve is limited in what it can accomplish through influencing the money flow. In the first place, the System can influence only one of the two determinants of the flow of money expenditures -- the quantity of money but not its velocity of circulation. Second, the instruments available to the System are more effective in checking a boom than in promoting recovery from a depression. Inflation can be checked by limiting the money supply, but expansion can only be encouraged during depression by making more reserves available. It

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is more effective "to pull on a string than to push"; nevertheless, by providing banks with an amply supply of reserves and putting a plentiful supply of funds in the market, the System can at least cushion a decline.....If labour and other organized groups exert enough pressure to force money incomes up faster than the increase in productivity, monetary and fiscal authorities may be confronted with choosing between two alternatives -- an expansion in the money supply to support higher costs and rising prices, or unemployment. Thus monetary and fiscal policies, no matter how well conceived and expertly executed, may not be able to maintain stability in the face of inappropriate wage and other income policies.

W. McC. Martin - 1961 Speech

The Federal Reserve intends now, as in the past, to make vigorous use of its monetary powers in order to contribute to the attainment of conditions conducive to a productive, actively employed, steadily growing economy with relatively stable prices.

But clearly those conditions cannot be provided by monetary policy alone. Help is needed, especially in directly attacking some of the problems of unemployment that cannot reasonably be solved by credit measures. Without such help, we might find at some point that the plague of unemployment was still with us, but by then it had been compounded by inflation.

What is needed, in my judgment, is a judicious blend of specific actions, well-balanced monetary and fiscal policies, and wage-price policies fitting to a vigorously competitive market structure......

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Neither can we afford to be priced out of the market by currency inflation: in our governmental processes we must guard against reckless budgetary and monetary practices that can undermine the value of our currency, and with it undermine our competitive position as both sellers and buyers of goods and services throughout the world.

Lord Cobbold - 1961

"I also accept -- indeed it is a theme which I have myself argued for many years past -- that monetary policy cannot cure all ills and that it is a great mistake to expect it to carry loads which should be carried in other fields of government policy." As quoted by Honourable Donald M. Fleming in the House of Commons, February 21, 1961.

Exhibit 44. J.E. Coyne -- 1960 Speech

.....In a serious depression, unemployment is of such a magnitude and of such a widespread character that general measures of monetary expansion and deficit financing may be expected to make a major contribution towards encouraging an increase in production and unemployment throughout the country. Of course, no great assistance will be derived by industries dependant upon export markets from an increase in spending and spending power merely within Canada itself. If, however, industries producing for the domestic market are also suffering from serious and general under-employment -- and if this is not due to high costs and inability to compete with imports but is a reflection of a low level of spending within the country -- it is apparent that general

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measures to increase the ability of people and businesses to spend, and to undertake new projects with the aid of borrowed money, may have a quite pronounced beneficial effect. Such measures can in such circumstances improve the rate of activity in industries producing for the domestic market, including of course a wide variety of service industries as well as goods-producing industries.

On the other hand, what has not been so widely recognized is that if unemployment is not general but is chiefly apparent in the export industries, or is scattered in particular industries or particular localities for reasons peculiar to those industries or localities, a general increase in money and credit, with or without a general degree of deficit spending by the government, will not necessarily have any useful effect on the particular areas of unemployment in question. Moreoever, if at such a time industries producing for the domestic market are for the most part operating at a high level -- or even if they are under-employed where the cause is inability to compete with imports -- one would expect that a general expansion of the money supply and of credit available through the banking system, or large scale government deficits, would tend to result in increased imports -- that is to say in a stimulus to production and employment outside Canada -- rather than increased production and employment inside Canada.

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APPENDIX D

MUNICIPAL FINANCE

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INTRODUCTION

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2. However, the Canadian municipality owes its existence and its authority to the province in which it is situated. Consequently, the provinces can and do exercise considerable control over their municipalities and accept substantial responsibility for their welfare. The provinces differ somewhat in their views as to the extent to which provincial authority and responsibility should be exercised, with the result that varying degrees of municipal autonomy and provincial assistance exist across Canada.

3. The municipality's special sphere of operations has created unique financing operations and market characteristics for municipal obligations which make it desirable to consider municipal capital financing

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I Sources of Capital

II Sale of New Debenture Issues by the Municipality

III The Evaluation of Municipal Debentures

IV The Market for Municipal Debentures

V Marketing Assistance from Senior Governments

I SOURCES OF CAPITAL

4. A municipality has three basic sources of capital, namely: current revenues, grants from senior governments and proceeds from the sale of its debentures. The federal and provincial governments do make capital grants for construction costs of certain works including hospitals, homes for the aged, some roads and bridges, schools, and water and sewer works, but the largest source of capital is the proceeds from the sale of new debentures.

5. The rapid population growth since 1945, as well as the trend to higher standards of municipal services, has resulted in constantly increasing municipal capital requirements. A number of provinces have adopted measures to assist municipalities in borrowing for these capital funds, including the establishment of provincial corporations to buy municipal debentures with funds raised by the sale of the corporations' own provincially guaranteed bonds. Such corporations include the Alberta Municipal Financing Corporation (a) and the Ontario Municipal Improvement Corporation (b). The former

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provides all capital funds required by Alberta municipalities at rates in accordance with the cost of money borrowed by the Corporation, plus operating costs. The latter is designed to provide capital only to those municipalities which are not in a position to borrow in the market at reasonable rates.

6. In some provinces, part of the capital raised by debenture sales is, in effect, provided by the province by means of annual grants of a percentage of annual service charges on debentures. This procedure helps preserve autonomy and self-reliance, as the municipality or school board still has an interest in striving for low borrowing costs. Such grants do result in lower borrowing costs. This occurs because the percentage of debenture debt supported by grants may be excluded from debt to be paid from taxes. In general, the lower the tax supported debt, the better the credit rating, resulting in lower borrowing costs.

(a) The Alberta Municipal Financing Corporation Act, Chapter 3, Statutes of Alberta, 1956.

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8. However, there are many Canadian municipalities which are not always in such a fortunate position. A municipality with a heavy borrowing programme in prospect for several years may be well advised to market its large issues through a fiscal agency group, thus assuring broad distribution facilities to assist in the successful sale of each issue. Municipalities which have adopted the fiscal agency method include the cities of Ottawa, Hamilton and Vancouver and the Municipality of Metropolitan Toronto.

9. A municipality in a special situation, one which needs its story well told, will also benefit from the services of fiscal agents. Such a municipality might have had past difficulties only recently overcome, be newly created, or have changed in character due to annexation or rapid urban development. Municipalities which have sold debentures through fiscal agents for one of these reasons include District of Kitimat, B.C., City of Windsor, Ontario, the County of Halifax, N.S. and the Township of Toronto, Ontario.

10. In general, the smaller but well administered municipality can afford to try for the highest possible price on each issue as it comes along, with the knowledge that a poor marketing operation on any one issue is unlikely to affect its general credit rating or its future issues.

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III THE EVALUATION OF MUNICIPAL DEBENTURES

12. The value of a municipal debenture is determined by comparing the features of the issuer with those of other municipal borrowers in order to establish a relative worth. Obviously certain basic information must be obtained before accurate evaluation can be made, and many dealers in municipal debentures have declined to bid for new issues, at one time or another, simply because sufficient information was not made available.

13. The items usually considered to be most important are the amount, quality and diversity of assessment, the tax collection record, the weight of debt and the debt history. A more detailed list of relevant items is contained in Exhibit "A:, appended. While the information referred to in this Exhibit is more detailed that is necessary in many instance, a good general rule is that the more information available, the more

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14. It is usually difficult to compare the financial positions of municipalities in different provinces because bases of assessment and municipal accounting procedures vary from province to province, and sometimes from municipality to municipality in the same province. Most provinces publish some form of annual municipal statistics which appear to be standardized for their own municipalities at least. Many of these publications are far from satisfactory, however, as they contain insufficient facts and little information. Steps should be taken to rectify this lack of data.

15. Once the basic value of a municipal debenture is established and an approximate market rate arrived at by comparison with other issues, this rate is adjusted for the features of the issue itself. These features include the term to maturity, redemption clause and coupon interest rates.

IV THE MARKET FOR MUNICIPAL DEBENTURES

16. Canadian and American investing institutions are the largest buyers of Canadian municipal debentures and slightly over sixty per cent of those outstanding are held by this category. The most important Canadian institutional purchasers of the shorter maturities are chartered banks, trust companies and Quebec financial co-operatives (caisses) and of the longer maturities, insurance companies and ~~pension~~ funds.

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18. The annual capital requirements of Canadian municipalities are substantial, the estimated $471 million requirements in 1961, representing some 46.5 per cent of total provincial financing. Exhibit "C" shows the dollar volume of new provincial and municipal issues sold in recent years. The dollar volume sold to Canadian institutional buyers has depended to some extent on the yield spread from provincial bonds. While insurance companies do allocate specific amounts of investment funds for the purchase of particular classes of securities, it has been proven many times that such allocations may be adjusted readily when one class appears more or less attractive in yield than others. It will be seen from the exhibit that substantial amounts of capital have been raised in the past through the sale of both provincial and municipal issues outside of Canada. This form of borrowing has been necessitated by the fact that demands on the internal market have been so heavy that it would have been difficult for it to completely absorb the volume of new issues. There has been the added advantage that in most cases external borrowings have been effected at more advantageous rates than were available in Canada at the time. However, the imposition of a 15 per cent Federal Withholding Tax could increase the cost to Canadian borrowers to such an extent as to make external borrowing uneconomical, as foreign investors require an increase in yield in order to compensate them for the loss involved due to the tax.

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With the large volume of financing facing our municipalities in the foreseeable future, we recommend that the tax be rescinded so that this source of funds will again be available to them.

19. The marketing of municipal debentures is more specialized than provincial and many corporate securities. One of the reasons for this is the preponderance of serial forms of issues. Some municipalities have adopted the installment type instead of the true serial. In its original form, a twenty year installment issue, which is based on equal annual installments of principal and interest, comprises twenty different maturities with a varying amount of debentures in each maturity and at least one debenture in each maturity with a par value of an odd number of dollars and cents. The maturities comprising an actual debenture issue which was marketed in 1960 are shown in Exhibit "D". It is difficult to sell serial issues to the general public because of the problems in merchandising so many different maturities, frequently at different dollar prices. Many investors dislike the bookkeeping and handling problems involved in a multi-maturity investment.

20. Institutional investors and private individuals form the two groups that purchase municipal and school debentures. The former may be divided into two categories, the chartered banks, trust companies and Quebec financial co-operatives forming one and insurance companies, pension funds and various government accounts the other. The first category usually prefers short term

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21. It is usually difficult to maintain active secondary markets for debentures of smaller borrowers. The operations of sinking funds would certainly create some demand for the outstanding debentures of these borrowers.

It will be helpful if sinking funds which are established against specific issues are not restricted to the purchases of debentures of those same issues but would be open to any debentures of the borrower. With the exception of larger municipalities, sinking funds should be supervised by the appropriate provincial authorities in order to provide knowledgeable assistance.

22. There are two federal requirements at present which tend to restrict the market for municipal and school board debentures to some extent. For the purpose of annual portfolio evaluation by Canadian Life insurance companies, the Department of Insurance allows

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the evaluation of federal and provincial obligations, both direct and guaranteed, to be the companies' amortized book values. However, this method is not accepted for municipal securities. This tends to make such obligations relatively more attractive than municipal obligations to life insurance companies than would otherwise be the case. Consideration should be given to allowing insurance companies to evaluate municipal debentures in a like manner.

23. The Department of Insurance in Ottawa requires non-resident insurance companies to deposit, with it, acceptable bonds and debentures as security for these companies" Canadian policy holders. Municipal debentures are acceptable for this purpose but school debentures are not eligible for deposit unless they bear a provincial or municipal guarantee. The acceptance of school debentures for deposit would benefit the market for these securities.

24. There is a strong feeling among many municipal officials that the issuance of tax-exempt debentures in Canada, similar to those issued by United States borrowers, would result in substantially lower debt service charges to Canadian issuers. At first glance this appears to be the case, but further study proves it to be doubtful. For instance pension funds, large buyers of municipal securities, would derive no benefit whatever from the exemption so that they would be lost to the market. Taxation of chartered banks and insurance companies is not based solely on investment income, so that the exemption might have little appeal to them and

their purchases could decrease. This would result in upper bracket taxable accounts being the principal source of capital available to municipalities and the volume that might be generated from this source might not be substantial. It is possible that a few tax-exempt issues might be successfully sold, but it would not take long for the yields on tax-exempts to increase so as to almost coincide with those on taxable securities. For these reasons we recommend that tax-exempt status not be given to municipal debentures. Recent experience in the United States tends to support this conclusion as is indicated by the appended quotation from an article "Should the Income Tax be Overhauled?" in the December 1961 Monthly Review, issued by The Federal Reserve Bank of Kansas City (Exhibit "E").

V MARKETING ASSISTANCE BY PROVINCIAL GOVERNMENTS

25. The various provinces assist their municipalities in one way or another to sell debentures. The simplest form of assistance, one which has proven very effective, is to require municipalities to provide information about their history, economic and financial condition, and details of the proposed issues. The information is included in standard information forms which are made available to prospective bidders. In some instances the provinces issue calls for tenders incorporating this information.

26. Another effective device is being used by some of the provinces in assisting in the marketing of school debentures. These provinces remit agreed upon

their purchases could decrease. This would result in upper bracket taxable accounts being the principal source of capital available to municipalities and the volume that might be generated from this source might not be substantial. It is possible that a few tax-exempt issues might be successfully sold, but it would not take long for the yields on tax-exempts to increase so as to almost coincide with those on taxable securities. For these reasons we recommend that tax-exempt status not be given to municipal debentures. Recent experience in the United States tends to support this conclusion as is indicated by the appended quotation from an article "Should the Income Tax be Overhauled?" in the December 1961 Monthly Review, issued by The Federal Reserve Bank of Kansas [illegible]).

V MARKETING ASSISTANCE BY PROVINCIAL [illegible]

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grants to the paying agents for the debentures with the proviso that the funds are to be used in the servicing of the debt in the years in which the grants are received. This improvement in the security of school debentures has resulted in borrowing costs being substantially lower than otherwise would have been the case. However, we recommend when grants are not statutory that they be made so rather than continuing the present practice of requisitioning the amounts annually. In addition to this their description in the texts of the debentures secured by them should assist in a wider acceptance of this type of investment.

27. In some provinces assistance has been offered to the underwriter, rather than directly to the municipality, by purchases by provincial accounts of some part of each issue. In some cases the purchasing intentions of these accounts are made known to dealers prior to the sale of the debentures. In other instances the province has made known its policy of assistance by government account purchases in the event that the issue is not successfully marketed within a reasonable time. This policy has had the double effect of increasing dealer confidence in underwriting municipal issues and of avoiding the adverse effects that unsold issues have on the new issues of adjacent and similar municipalities.

28. Probably the most effective form of provincial marketing assistance has been the provincial guarantee of principal and interest payments. All provinces have resorted to this device at one time or another and it is undoubtedly of major assistance in

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marketing issues of little know or low rated municipalities and school-boards.

MUNICIPAL FINANCE, RECOMMENDATIONS FOR THE I.D.A.C. BRIEF

Pr. 22 Page 7 — a) We recommend that life insurance companies be permitted to evaluate their holdings of municipal securities at the amortized book values following the same practice as for federal and provincial obligations.

Pr. 23 page 7 — b) We recommend that the Federal Department of Insurance accept school debentures for deposit by non-resident insurance companies.

Pr. 24, page 8 Exhibit "E" — c) We recommend that the tax status of interest payments on municipal debentures remain unchanged.

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EXHIBIT "A"

Evaluation of Municipal Debentures

Factors Affecting a Municipality's Credit Rating

General

1. Geographical location

2. Physical appearance, size (acreage)

3. Economy - a) type - agricultural, industrial etc.

- b) extent and wealth of marketing area

- c) quality of housing

4. Condition and extent of municipal facilities

- a) water service

- b) sewer service and treatment

- c) roads, sidewalks, bridges

5. Extent of control over development

- a) zoning by law

- b) in rural or semi-rural, method of controlling urban growth

6. Management

- ability of council and political climate

- ability of appointed officers

Statistical Statistics for at least the past five years are examined so that trends may be detected.

7. Population

- a) total

- b) rate payers

8. Assessment

- a) residential, commercial and industrial categories

- b) per capita

Exhibit "A" - continued

- c) relationship to current market values

- d) exemptions

9. Current Operations

- a) accuracy of budgeting as evidenced by annual surpluses or deficits and outstanding temporary loans

- b) ability of taxpayers to pay and the municipality to collect taxes as shown by current and total tax collections as a percentage of current levy and total outstanding tax arrears as a percentage of current levy and per capita. Explanation of arrears, if unduly high, such as date tax bills are sent out.

- c) reserves against tax arrears and breakdown of arrears into years in which they occurred.

10. Debt

- a) breakdown: self-supporting

  local improvements

  general service debt

- b) ability to pay off debenture debt as indicated by the relationship of debt repayable from taxation to population and assessment and by the percentage that annual debt charges are of annual current revenues.

- c) willingness to pay as indicated by debt history.

- d) forecast of future borrowing.

Exhibit "A" - continued

- c) relationship to current market values

- d) exemptions

9. Current Operations

- a) accuracy of budgeting as evidenced by annual surpluses or deficits and outstanding temporary loans

- b) ability of taxpayers to pay and the municipality to collect taxes as shown by current and total tax collections as a percentage of current levy and total outstanding tax arrears as a percentage of current levy and per capita. Explanation of arrears, if unduly high, such as date tax bills are sent out.

- c) reserves against tax arrears and breakdown of arrears into years in which they occurred.

10. Debt

- a) breakdown: self-supporting

  local improvements

  general revenue debt

- b) ability to pay off debenture debt as indicated by the relationship of debt repayable from taxation to population and assessment and by the percentage that annual debt charges are of annual current revenue;

- c) willingness to pay as indicated by debt history.

- d) forecast of future borrowing.

EXHIBIT "B"

ESTIMATED DISTRIBTION OF HOLDINGS
OF
MUNICIPAL DIRECT & GUARANTEED DEBENTURES

(Source: Bank of Canada Statistical Summary, January 1962).

As at December 31, in $ millions

	1956	1957	1958	1959	1960(1)
Life Insurance Companies (2)	399	427	456	507	547
Provincial Governments (3)	156	192	237	257	286
Pension Plans	158	170	183	205	235
Chartered Banks	185	168	195	204	208
Municipal Governments (4)	117	137	158	191	207
Other Insurance Companies (5)	85	97	103	110	121
Trust & Mortgage Loan Companies (6)	48	47	55	55	71
Quebec Savings Banks	56	52	53	47	41
All other residents (residual)	673	764	819	883	955
TOTAL RESIDENT HOLDINGS	1,877	2,054	2,259	2,459	2,671
Non-Resident Holdings	550	656	780	912	1,024
TOTAL	2,427	2.710	3,039	3,371	3,695

Notes:
(1) Estimated
(2) Registered under Federal Insurance Acts
(3) Includes holdings of various Funds under provincial jurisdiction such as hydro commission, workmen's compensation boards, sinking Funds, teachers and civil service pension and superannuation Funds.
(4) Based on a sample of those large cities which provide details of their investments in their published annual reports. Includes holdings of various funds under municipal jurisdiction such as sinking Funds and pension Funds.
(5) Fire and casualty insurance companies and fraternal benefit societies registered under Federal Insurance Acts.
(6) Holdings of all such companies registered with the Government of Canada of the Province of Ontario, or Quebec, plus holdings of Investors Syndicate of Canada Limited (incorporated in Manitoba).

EXHIBIT "L"

ESTIMATED DISTRIBUTION OF HOLDINGS
OF
MUNICIPAL DIRECT & GUARANTEED DEBENTURES

(Source: Bank of Canada Statistical Summary, January 1960).

As at December 31, in $ millions

	1956	1957	1958	1959	1960(1)
Life Insurance Companies (2)	399	427	456	507	547
Provincial Governments (3)	154	[illegible]	237	257	[illegible]
Pension Plans	158	170	183	205	235
Chartered Banks	185	168	195	204	[illegible]
Municipal Investments (4)	117	131	159	[illegible]	[illegible]
Insurance Companies (5)	[illegible]	91	103	110	121
Trust & Mortgage Loan Companies (6)	48	47	55	55	71
Quebec Savings Banks	56	52	53	47	41
All other residents (residual)	673	764	819	883	955
TOTAL RESIDENT HOLDINGS	1,877	2,054	2,259	2,459	2,671
Non-Resident Holdings	550	656	780	912	1,024
TOTAL	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Notes: (1) Estimated
(2) Registered under Federal Insurance Acts
(3) [illegible]
(4) [illegible]
(5) [illegible]
(6) [illegible] (Incorporated in Manitoba).

EXHIBIT "C"

GROSS NEW ISSUES, RETIREMENTS AND NET NEW ISSUES
of
MUNICIPAL DIRECT AND GUARANTEED BONDS (1)

Calendar Year	Gross New Issues Delivered: Cdn.$ Only	Gross New Issues Delivered: Other Currencies	Gross New Issues Delivered: Total	Retirements (2): Cdn.$ Only	Retirements (2): Other Currencies	Retirements (2): Total	Net New Issues: Cdn.$ Only	Net New Issues: Other Currencies	Net New Issues: Total
1954	305	38	343	83	20	103	222	18	240
1955	302	42	344	86	25	111	217	17	234
1956	247	108	355	107	24	131	140	84	224
1957	292	123	414	110	26	136	181	97	278
1958	347	148	495	139	33	172	208	115	323
1959	370	146	516	157	33	191	213	113	326
1960	411	122	533	177	38	214	234	85	319
1961	445	29	474	180	41	221	265	(12)	252

NOTES: (1) Excluding Municipal issues guaranteed by provinces, and issues sold directly to provinces.
(2) Excluding Payments into sinking funds.

Source: Bank of Canada Statistical Summary, February 1962.

EXHIBIT "D"

GROSS NEW ISSUES, RETIREMENTS AND NET NEW ISSUES
of
MUNICIPAL DIRECT AND GUARANTEED BONDS (1)

Calendar Year	Gross New Issues Delivered: Cdn.$ Only	Other Currencies	Total	Retirements (2): Cdn.$ Only	Other Currencies	Total	Net New Issues: Cdn.$ Only	Other Currencies	Total
1954	305	38	343	83	20	103	222	18	240
1955	302	42	344	86	25	111	217	17	234
1956	247	108	355	107	24	131	140	84	224
1957	292	123	414	110	26	136	181	97	278
1958	347	148	495	139	33	172	208	115	323
1959	370	146	516	157	33	191	213	113	326
1960	411	122	533	177	38	214	234	85	319
1961	445	29	474	180	41	221	265	(12)	252

Source: Bank of Canada Statistical Summary, February 1962.

Exhibit "D"

$1,063,732.52
CITY OF CORNWALL
6% and 6½% Instalment Debentures

Schedule of Maturities

Year	$12,000.00 Garage #1,017 Dated: Oct. 1/60 6%	$75,000.00 Land and Buildings #1,041 Dated: Oct. 1/60 6%	$86,125.53 Waterworks #1,016 Dated: Oct. 1/60 6%	$306,412.60 Local Improvements #1,037 Dated: Oct. 1/60 6%	$102,797.22 Public Sch. Board #1,014 Dated: Sept. 1/60 6%	$126,059.56 Waterworks #1,015 Dated: Oct. 1/60 6%	$150,000.00 Cornwall Gen. Hospital #1,042 Dated: Oct. 1/60 6%	$161,259.35 Filtration Plant # 949 Dated: June 1/60 6%	$2,510.60 Local Improvements # 943 Dated: June 1/60 6½%	$3,744.47 Local Improvements # 942 Dated: June 1/60 6½%	$37,823.19 Local Improvements # 941 Dated: June 1/60 6½%
1961	$2,128.76	$ 5,690.10	$ 6,534.17	$ 23,246.91	$ 2,794.50	$ 3,426.88	$ 4,077.68	$ 4,383.77	$ 186.05	$ 277.48	$ 2,802.83
1962	2,256.48	6,031.50	6,926.22	24,641.71	2,962.17	3,632.49	4,322.34	4,646.79	198.14	295.52	2,985.06
1963	2,391.87	6,393.39	7,341.79	26,120.22	3,139.90	3,850.44	4,581.69	4,925.60	211.02	314.73	3,179.09
1964	2,535.38	6,777.00	7,782.30	27,687.43	3,328.29	4,081.47	4,856.59	5,221.14	224.74	335.19	3,385.73
1965	2,687.51	7,183.62	8,249.24	29,348.68	3,527.99	4,326.35	5,147.99	5,534.40	239.34	356.97	3,605.81
1966		7,614.63	8,744.19	31,109.60	3,739.67	4,585.93	5,456.87	5,866.47	254.90	380.18	3,840.18
1967		8,071.51	9,268.84	32,976.16	3,964.05	4,861.09	5,784.28	6,218.46	271.47	404.89	4,089.80
1968		8,555.80	9,824.97	34,954.73	4,201.89	5,152.76	6,131.33	6,591.56	289.12	431.20	4,355.63
1969		9,069.15	10,414.47	37,052.02	4,454.00	5,461.92	6,499.21	6,987.06	307.90	459.23	4,638.75
1970		9,613.30	11,039.34	39,275.14	4,721.24	5,789.64	6,889.16	7,406.28	327.92	489.08	4,940.26
1971					5,004.52	6,137.02	7,302.51	7,850.65			
1972					5,304.79	6,505.24	7,740.66	8,321.69			
1973					5,623.08	6,895.55	8,205.10	8,820.99			
1974					5,960.46	7,309.28	8,697.41	9,350.25			
1975					6,318.09	7,747.84	9,219.25	9,911.27			
1976					6,697.18	8,212.71	9,772.41	10,505.94			
1977					7,099.01	8,705.47	10,358.75	11,136.30			
1978					7,524.94	9,227.80	10,980.27	11,804.48			
1979					7,976.43	9,781.47	11,639.08	12,512.74			
1980					8,455.02	10,368.21	12,337.42	13,263.51			
	$12,000.00	$75,000.00	$86,125.53	$ 306,412.60	$102,797.22	$126,059.56	$150,000.00	$ 161,259.35	$2,510.60	$3,744.47	$37,823.19

FEDERAL RESERVE BANK OF KANSAS CITY

MONTHLY REVIEW

December 1961

Should the Income Tax be Overhauled?

Taxing State and Local Interest

A clear-cut example of the economic effects of favoured tax status is found in the market for state and local securities. Because interest paid on these securities is exempt from the Federal income tax, investors are willing to buy state and local bonds as lower yields than those available on other securities.... The preference of investors for tax-exempt bonds has made it possible for state and local governments to borrow at rates substantially below rates paid by other borrowers. However, as state and local government borrowing has mushroomed over the postwar period, the demand of high bracket taxpayers for tax-exempt securities has tended to become satiated. It has thus become increasingly necessary for nontaxable bonds to carry yields that make them appealing to investors in lower tax brackets. In consequence, the rate advantage for state and local issues has diminished considerably in recent years, while the advantage of investing in tax-exempt issues has been enhanced for people in higher tax brackets.

In 1946, tax-exempt issues rated Aaa sold at yields less than one half as high as those on corporate securities of comparable quality. The subsequent heavy volume of municipal offerings has progressively reduced this differential. Last year, for example, Aaa-

FEDERAL RESERVE BANK OF KANSAS CITY

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rated state and local issues sold at rates nearly three fourths as high as those on comparable corporate issues. It was thus possible for investors in the highest brackets to find substantial shelter from tax progression. A taxpayer in the highest (91 per cent) bracket could realize a tax-free return of $32,600 per year on a $1 million investment in Aaa-rated state and local bonds at the average rate available in 1960. He could earn, after tax, only about $4,000 annually from an equal investment in Aaa-rated corporate issues at the average rate for 1960.

Not only does this state of affairs provide an unwarranted haven from tax progression, it is often argued, but it also encourages investment in rather safe securities by those who are in the best position to finance riskier private undertakings, the income from which is taxable.

Tax exemptions of state and local interest payments has often been defended on the ground that it subsidizes desirable spending programs by reducing the borrowing costs of lower levels of government. However, the postwar decline of the differential between tax-exempt bonds and taxable issues has called into serious question the efficiency of the tax exemption feature as a subsidy for state and local borrowing. Taxpayers in high brackets save in taxes (and the Federal Government thereby loses in revenue) an amount far in excess of the saving of interest costs to lower levels of government.

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APPENDIX "E"

Part I - Corporation Finance

Part II - Legislation.

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CORPORATION FINANCE

1. A discussion of corporation finance should logically begin with an examination of companies themselves -- how they have grown, how much money has been used in the expansion of corporate enterprise and how this expansion has been financed. It is unfortunate that no one set of figures exists that permits a definitive analysis of changes in the structure of Canadian corporate finance. There are, however, statistics published by various authorities from which conclusions can be drawn that in general are probably fairly accurate.

2. The most comprehensive of these are the taxation data published by the Department of National Revenue, the latest of which relate to the year 1959. During the ten years 1949-59 the number of fully tabulated companies in Canada rose from 35,706 to 86,996; their assets, net of depreciation and depletion writeoffs, grew threefold from $21 billion to $63 billion. The following is a summary of the source and application of funds of Canadian business over this ten year period, as derived from the Taxation Statistics.

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- E -

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TABLE I

Source and Application of Funds of Canadian Business 1949-59

Application	($ billions)
Increase in net working capital	10.0
Increase in gross fixed assets	23.4
Net investment in subsidiaries and affiliates	7.5
Increase in other assets	2.2
Total applications	43.1
Sources	
Depreciation, depletion, etc.	8.7
Retained earnings and other surplus	11.3
Total internal sources	20.0
Other liabilities	6.8
Debt	7.8
Equity (preferred and common stock)	8.5
	43.1

"Other liabilities" include loans due to affiliated companies, liabil ity reserves (including deferred taxes) and deferred income.

3. Four important reservations apply to these figures:

1) The increase in fixed assets and in depreciation is after sales of fixed assets, for which figures are not published. Other data published in the taxation statistics show total capital expenditures by tabulated companies from 1950-59 as $26.4 billions. Capital cost allowances claimed for tax

TABLE 1

Source and Application of Funds of Canadian Business 1949-59

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Total applications	43.1

Source	
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Retained earnings and other surplus	11.3
Total internal sources	20.0
Other liabilities	6.8
Debt	7.8
Equity (preferred and common stock)	8.5
	[illegible]

"Other liabilities" include loans due to affiliated companies, liability [illegible] and deferred income.

5. Four important reservations apply to these figures:

1) The increase in fixed assets and in depreciation is after sales of fixed assets, for which figures are not published. Other data published in the taxation statistics show total capital expenditures by tabulated companies from 1950-59 as $26.4 billions. Capital cost allowances claimed for tax

purposes amounted to $14.8 billions, or 56.2 per cent of this amount while retained earnings were a further $7.6 billions, or 28.3 per cent. Cash dividends paid added up to $10.5 billions out of net profits of $18 billions, an average pay-out of 60 per cent.

2) The increase in surplus includes capital surplus, part of which would consist of proceeds from sale of stock in excess of par value.

3) The increase in common and preferred stock would include capitalization of earnings by way of stock dividends.

4) There is a certain amount of "double counting" because of the inclusion of all holding companies and their subsidiaries. For example, the full balance sheet of Aluminum Ltd. is included as well as the full balance sheet of the Aluminum Company of Canada. The "net investment in subsidiaries and affiliates" of $7.5 billion can be related to the increase in "other liabilities" of $6.8 billion and the rise in equity of $8.5 billion.

5) The companies include wholly owned subsidiaries of foreign concerns, whose financial requirements have, in large measure, been supplied by non-residents. The pattern of financing may well differ

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5) The companies include wholly owned subsidiaries of foreign concerns, whose financial requirements have, in large measure, been supplied by non-residents. The pattern of financing may well differ

from that of domestic companies.

4. Subject to these qualifications the table indicates that 38 per cent of the total application of funds was derived from the issuance of long-term debt and equity securities, this proportion being fairly evenly divided between the two.

5. A further qualification, however, is that arising from changes in the relative importance of certain types of business. For example, the group comprising finance, insurance and real estate (which does not include the chartered banks and insurance companies as these are not tabulated) has grown at an above average rate and in 1959 possessed approximately a quarter of the total assets of all fully tabulated companies. This group accounted for half of the net investment in subsidiary and affiliated companies over the ten year period, for 42 per cent of the increase in net working capital and 37 per cent of the increase in debt. Debt represents a higher proportion of capitalization for these companies than for business in general. This applies also to utilities, for which there has been a considerable amount of debt financing in the past five years, partly in connection with the establishment of new natural gas transmission and distribution companies.

6. It is therefore informative to look briefly at that important and reasonably consistent group of companies engaged primarily in manufacturing. Here, of the total applications of $14.1 billion over the period 1949-59, 60 per cent was derived from

Nethercut & Young
Toronto, Ontario

[illegible]

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internally generated funds, 13.5 per cent from "other liabilities", 12 per cent from the issuance of debt and 14.5 per cent from common and preferred stock.

TABLE II

Application	($ billions)
Increase in net working capital	2.9
Increase in gross fixed assets	9.1
Net investment in subsidiaries and affiliates	1.9
Increase in other assets	.2
Total applications	14.1
Sources	
Depreciation, depletion, etc.	4.1
Retained earnings and other surplus	4.3
Total internal sources	8.4
Other liabilities	1.9
Debt	1.7
Equity (preferred and common stock)	2.1
	14.1

7. From the more detailed data published on manufacturing in the Taxation Statistics it is interesting to note that capital expenditures over the ten year period amounted to $11 billion - nearly $2 billion more than the net increase in fixed assets as shown in the balance sheets - while capital cost allowances claimed for tax purposes totalled $6.7 billion - $2.6 billion more than the increase in depreciation reserves shown in the balance sheets. In effect, capital cost allowances were equivalent to 60 per cent of capital outlays during the

period.

8. Reflecting the important contribution of internally generated funds, there has been very little weakening in the financial structure of manufacturing companies over the period under review. The working capital ratio, which was 3 in 1949, was 2.75 in 1959; net tangible assets were 8.5 times debt compared with 6 times in 1959; and debt constituted 12 per cent of capitalization as against 17 per cent.

9. Nevertheless, the trend towards a higher proportion of debt in the structure of capitalization is apparent. The reasons, too, are obvious. In some cases, particularly with smaller companies, there is a desire not to dilute ownership of the company. The leverage benefits to common shareholders when earnings are on a generally rising trend, and when return on investment is greater than the cost of servicing debt, favour the issuance of debt within the limits imposed by financial soundness. There are generally accepted rules of thumb in the financial community, developed through experience and which are usually incorporated as covenants in trust deeds, that set these limits. They naturally vary from industry to industry, but in general it can be said that for manufacturing companies it is not considered desirable for debt to represent more than 40 per cent of total capitalization, while for utilities the proportion should not generally exceed 60 per cent (although in certain special cases it could with safety be higher). Similarly interest charges in most cases should be covered at least 3 to 5 times by earnings after

[illegible]

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depreciation, but for utilities, because of the greater stability of earnings, a 2 to 2½ times coverage may be sufficient.

10. Aside from the factor of leverage there is the further element of cost. Since interest payments may be deducted from corporate income for tax purposes, whereas dividends are not, the cost of issuing debt has been noticeably lower throughout the postwar period than the cost of raising funds through the issue of preferred or common stock. The higher the rate of corporate income tax, the greater is the cost differential. In the late 1920's, for example, taxes amounted to only 10 per cent or less of corporate profits, and with the difference between bond and stock yields at that time it was cheaper to issue common stock (although this did not prevent extensive debt financing). Today the tax rate is 50 per cent to 53 per cent, and a company can afford to pay interest at the rate of 8 per cent before the net cost exceeds a dividend rate on shares of 4 per cent. Should the tax rate fall to 40 per cent, then an interest rate of 6.7 per cent would be equivalent to a divident rate of 4 per cent. It would be easier to justify the issuance of stock under such conditions.

11. There has been a pronounced tendency over the years for the corporate income tax rate to creep upward. The ramifications of this are many and varied, but the incentive it provides for unsound corporate financing is one which, we feel, should be carefully considered. It would obviously be impractical to suggest

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reducing the corporate tax without at the same time pointing out other areas where increased tax revenues might be obtained or expenditures reduced. This could only be done in a comprehensive analysis of the situation of Canadian taxation. We understand that Queen's University is engaged in a study of this nature at the present time.

12. It is not surprising to find considerable difference in financial structure according to the size of companies. As shown by the following table constructed from the Taxation Statistics for the year 1959, smaller firms have relatively more recourse to bank financing than the larger; debt constitutes a smaller proportion of capitalization (and much of the debt is represented by mortgages); stock is of much greater importance; and a higher proportion of net profit is retained. These differences reflect the greater ease with which larger, mature companies with long established records of earnings can obtain funds, particularly debt funds, in the market. To some extent they may also reflect the different industries typical of the various asset sizes.

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TABLE III

Financial Structure of Manufacturing Companies by Size of Total Assets - 1959

Companies with Assets	Total Assets ($ billions)	Working Capital Ratio	% Composition of Capitalization Debt	Preferred	Common Stk.	Surplus	Total
Less than $100,000	236.6	1.26	6.5%	21.9%	48.0%	23.6%	100%
100 - 250,000	544.4	1.49	8.7	17.2	23.3	50.8	100%
250 - 500,000	622.5	1.61	7.4	16.4	20.9	55.3	100%
500 -1,000,000	859.5	1.72	6.3	10.1	21.6	61.9	100%
1- 5,000,000	2,499.2	2.22	9.8	10.5	18.7	61.0	100%
5- 10,000,000	1,453.5	2.61	10.00	6.4	22.3	61.3	100%
10- 25,000,000	2,140.9	2.96	15.9	7.8	22.6	53.6	100%
25- 100,000,000	4,763.9	2.76	16.1	6.1	26.1	51.7	100%
100,000,000 - over	7,000.1	2.35	22.3	3.9	26.2	47.6	100%

TABLE III

Financial Structure of Manufacturing Companies by Size of Total Assets - 1950

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1- 5,000,000	2,499.2	2.22	9.8	10.5	18.7	61.0	100%
5- 10,000,000	1,453.5	2.61	10.00	6.4	22.3	61.3	100%
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BANK OF CANADA DATA

13. The Taxation Statistics apply to all tabulated companies, whether they are privately owned or public, whether they are wholly-owned subsidiaries of foreign parents, or only partially controlled, and whether they are subsidiaries of Canadian firms or independent. The degree to which they have issued debt, preferred stock or common stock does not therefore necessarily bear any relation to the size or composition of security issues in the capital markets.

14. The Bank of Canada, however, publishes data on net new issues of securities by Canadian companies, including banks. These show that from 1949 to 1960 inclusive $8.8 billion was raised from the issuance of securities, broken down as follows:

Debt	$5.2 billion
Preferred Stock	.6
Common Stock	3.0

15. Of the amount raised through sale of common stock $390 million represented rights offerings of the chartered banks and $472 million rights offerings of The Bell Telephone Company of Canada. Together these accounted for 28 per cent of the total net new issues of common stocks. Taken in conjunction with the taxation figures, the above show conclusively that the issuance of debt has been much greater than that of equity securities. The proportion represented by debt has fluctuated considerably from year to year, the high being 76.8 per cent in 1950 and the low 21.2 per cent in 1959 -- a year of extreme difficulty in the bond markets.

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But the average for 1949-56 was 56.3 per cent and for 1957-60 59.5 per cent, indicating very little change from the period of sharp expansion to that of decline in business capital expenditures.

16. Rights offerings have been a frequent method of raising funds through common stock (the main reason being that the preemptive rights of the shareholders are protected) and these probably account for a considerable proportion of the remainder of the corporate stock financing. There have, however, been a number of new large companies formed during the past decade, notably among natural gas utilities and finance companies, which have had public issues of common stock, and particularly in recent years a number of smaller firms have come to the market. There have also been new companies established by European interests with Canadian participation usually by means of participating preferred shares. On the other hand, other companies have been acquired by larger firms and their shares either have disappeared entirely or the amount outstanding in the hands of the public has been reduced substantially. One industry in which this has occurred to a considerable degree is pulp and paper. Thus the number of stocks listed on the Toronto Stock Exchange rose only from 867 at the end of 1948 to 1,117 at the end of 1961, and most of this increase was in junior mining and petroleum companies.

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18. "Once the underwriter is chosen, an 'underwriting agreement' is drawn up. Some of the features of this contract are fairly standard. It will usually take the form of a letter from the underwriter to the issuer. The letter will describe the security involved and constitute an offer to purchase the issue under certain conditions. The price will probably not be made definite until just before the underwriter signs the letter and the issuer signs an acceptance, and this will not take place until just before the offer to the public. However, a price range may be tentatively established at an early stage.

19. "The conditions set forth in the letter will include some standard ones. The issuer will be required to fulfill all legal requirements as to the issue of the securities and as to their offer for sale throughout Canada (often excepting Newfoundland and Prince Edward Island). This will include compliance with the applicable companies acts and the provincial securities acts. The underwriter's commitment will be subject to a favourable opinion of its counsel as to the legality of the issue and its sale, and the issuer will probably pay for this opinion.

20. "The accuracy of the prospectus will be made the issuer's responsibility. The companies acts and securities acts, where they impose liability to purchasers for omissions and misstatements in a prospectus, sometimes make the underwriters equally liable with the issuer. Hence, the underwriting agreement will

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21. "The issuer will be required to furnish whatever financial and statistical information is reasonably necessary for selling purposes, including audited financial statements, if these are appropriate.

22. "Finally, there will be some sort of escape clause, a so-called 'market out' clause. This will give the underwriter an option to terminate the agreement, usually up until the time the prospectus is accepted for filing and a public offering may lawfully begin, in the event of (to quote one such agreement) 'any catastrophe of national or international effect which, in our opinion (that is, the underwriter's opinion), is adverse, or any action, government regulation or other occurrence of any nature whatsoever which, in our opinion, seriously affects or may seriously affect your business or the financial markets'. It is unlikely that the clause will ever be used by the underwriter. It is, after all, the market rise (in a less severe form perhaps) that the underwriter is being paid to take, and except in a real crisis a reputable underwriter will not exercise its escape rights.

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25. "The principal underwriter will be a member of the banking group, and its syndicate manager. The name of the manager will always appear first in the list of underwriters in a prospectus -- this is a mark of prestige about which underwriting firms are sensitive. The banking group agreement will consist of a letter from the syndicate manager to each of the group members. Actually 'group agreement' may be a little misleading. There is no agreement among the members; each signs an identical agreement (identical except for the size of the participation) with the manager alone.

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27. "The entire letter constituting the banking group agreement is pretty much standard, apart from the description of the securities. The manager will reserve a specified percentage of each member's participation, for sales to 'exempted institutions' (meaning institutional investors, such as insurance companies, whom the other members agree not to solicit) and to a selling group. These sales are handled exclusively by the manager, selling for the accounts of the banking group members. The remainder of a member's participation will be sold through its own facilities.

28. "The offering prices will be set out -- tentatively, until the offering day -- and depending on the kind of securities offered, these may include prices to the public, to exempted institutions, to various dealers, and to banking group members. And the letter will specify the date on which the member is required to take delivery of its securities and pay for them.

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31. "The next stage in the distribution is the selling group. There are two ways in which the syndicate manager may form a selling group. One is simply to make offers to a number of dealers, which, when accepted, become sales. This method may be useful where the selling group is small, but the more common procedure is to invite orders from selected dealers, without making a commitment. The invitation is in the form of a letter, called a 'selling group agreement', from the manager, and is generally sent out on the day registration of the securities is complete. The manager opens a subscription book a day or two afrer the

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invitation goes out, and accepts orders or allots proportion of orders if the demand is great.

32. "As an example, the prices on a bond purchased at 97 by the manager might be:

Retail price	$100.00
Price to exempted institutions	100.00
Price to trust companies for resale to clients at the retail price	99.75
Price to casual dealers	99.25
Price to selling group members	98.50
Draw-down price to banking group members, and selling group members	98.50
Cost to banking group members	97.75

The difference between the $97.75 cost to Banking Group Members and the $98.50 draw-down price is an amount withheld by the syndicate manager to cover the expenses of the issue. Any balance of this 'holdback' not required for expenses is returned to the members. The price concession to trust companies would apply only in Quebec, where such concessions are legal.

33. "The selling group agreement, like the banking group agreement, follows a standard form. The manager signs the letter to the dealers as agent for the banking group, so that whatever contract results is between a dealer and the group. After describing the issue, the letter offers to include the addressee in a selling group, and there is a place provided for the dealer to sign in acceptance of this offer, which imposes certain obligations on him (these are discussed below). However, as to the extent of his participation,

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36. In addition to "firm commitment underwriting", issues may be privately placed with one or more institutions in Canada or the United States. In this case the investment dealer acts simply as agent for the issuer, or may do nothing more than bring two parties together, using his knowledge of the investment policies of various institutions. For these services the dealer usually receives a moderate commission which will probably range between 1/4 and 1 1/2 per cent depending on how much work has been involved and the size of the issue. Moreover, no registration statement is required for private placements with institutions. Hence the expenses of issue are lower than for a public offering. On the other hand, a slightly higher yield must usually be given to the lender and the covenants may be more restrictive, while the company does not derive the advantage of more widespread ownership (e.g. the public relations aspect, and public familiarity with the

only an invitation is made and the banking group is not bound to deliver securities until it has accepted the dealer's order

34. "The selling group agreement repeats such of the banking group agreement, including a schedule of prices. The members of the selling group are required to comply with securities legislation, and specifically to agree not to solicit orders in the provinces where the securities will not be registered or where the dealer is not qualified to do business (nor to solicit in the United States, unless the securities are to be registered there)."

36. In addition to "firm commitment underwriting", issues may be privately placed with one or more institutions in Canada or the United States. In this case the investment dealer acts simply as agent for the issuer, or may do nothing more than bring two parties together, using his knowledge of the investment policies of various institutions. For these services the dealer usually receives a moderate commission which will probably range between 1/4 and 1 1/2 per cent depending on how much work has been involved and the size of the issue. Moreover, no registration statement is required for private placements with institutions. Hence the expenses of issue are lower than for a public offering. On the other hand, a slightly higher yield must usually be given to the lender and the covenants may be more restrictive, while the company does not derive the advantage of more widespread ownership (e.g. the public relations aspect, and public familiarity with the

company which may be helpful in subsequent issues of securities).

37. Occasionally, and particularly in the case of small issues, an underwriting may be on a "best efforts" basis, whereby the dealer undertakes to use his best efforts to sell the securities as an agent of the issuer, receiving a straight commission on sales made.

38. A major underwriter has a twofold responsibility. One is to provide sound advice to the companies for which it acts as fiscal agent and underwrite securities on the best terms and lowest over-all costs consistent with the issuing company's financial position and the condition of the securities markets. But an underwriter also has an established clientele to whom it sells the new issues that it underwrites or in which it participates. Its reputation as an underwriter is in part determined by its "placement" power. And it has a responsibility to its clients to correctly represent the quality of an issue and ensure that the return to the investor is commensurate with the degree of risk taken. As further protection to its clients and to its own reputation, the underwriting house will usually maintain a watching brief on the progress of a company for which it acts as fiscal agent, frequently to the extent of being represented on the board of directors. If a company does run into difficulties the underwriter often plays an active role in overcoming them, occasionally placing its own resources behind the credit of the company if the need arises.

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DISTRIBUTION OF BONDS

TABLE III-A

Estimated distribution of holdings - Corporate and other non-Government Bonds

(dollar figures in thousands)

Holder	1959 Principal Amount	1959 % of Total	1954 Principal Amount	1954 % of Total	Change 1954/9
1.Bank of Canada	59	1	11		+ 48
2.Chartered Banks	512	7	353		+ 159
3.Provincial Governments	24	-	50		- 26
4.Municipal Governments	15	-	1		+ 14
5.Life Insurance Companies	1924	27	1407	33	+ 517
6.Other Insurance Companies	132	2	64		+ 68
7.Quebec Savings Banks	21	-	16		+ 5
8.Trust & Mortgage Loan Co.	160	2	81		+ 79
9.Pension Plans	473	7)	) 742		+ 1062
10.All other Residents	1331	19)			
11.Total Residents	4651	65	2725	65	+1926
12. Non Resident	2479	35	1498	35	+ 981
	7130	100	4223	100	+ 2907

Source: Bank of Canada Statistical Summary Supplement 1960.

DISTRIBUTION OF BONDS

TABLE [illegible]

Estimated distribution of holdings -
Corporate and other non-Government
[illegible]

(dollar figures in thousands)

Holder	[illegible] Principal Amount	% of Total	1954 Principal Amount	% of Total	Change 1954/59
1. Bank of Canada	59	1	[illegible]		[illegible]
2. Chartered Banks	512	[illegible]	353		+ 159
3. Provincial Governments	24		50		- 26
4. Municipal Governments	15		1		+ 14
5. Life Insurance Companies	[illegible]	[illegible]	1407	33	+ 517
6. Other Insurance Companies	132		64		+ 68
7. Quebec Savings Banks	21		15		+ 6
8. Trust & Mortgage Loan Co.	160	[illegible]	81		+ 79
9. Pension Plans	473	[illegible]	[illegible]		+ [illegible]
10. All other Residents	1331	[illegible]			
11. Total Residents	4651	[illegible]	2725	65	+ 1926
12. Non Resident	2479	[illegible]	1498	35	+ 981
	7130	100	4223	100	+ 2907

[illegible]: Bank of Canada Statistical Summary Supplement 1960.

38A. From the foregoing it can be observed that (1) domestic institutions and pension funds comprise the largest market for corporate bonds, accounting in 1959 for some $3,320 millions principal amount equivalent to roughly 46.5 per cent of outstanding corporate debt obligations, (2) the life insurance industry is the largest single market for corporate bonds, and (3) non-residents have acquired roughly 35 per cent of Canadian corporate and other bonds. The (life) insurance industry in 1959 owned $2,056 millions principal amount of corporate bonds, equivalent to approximately 29 per cent of the total outstanding principal amount of Canadian corporate and other bonds. In 1954 however, this industry owned $1,471 millions principal amount of corporate bonds, equivalent at that time to roughly 35 per cent of the total outstanding principal amount of Canadian corporate and other non-government bonds.

38B. This trend is significant for the investment dealer as it points out that problems in the distribution of corporate bonds are becoming more complex; for though there are several large buyers, in itself a factor tending to somewhat simplify the distribution process, the reduction in the leading role of the insurance industry requires the investment dealer to turn to several other sources.

38C. In passing it is worth noting that the insurance industry in the United States of America is a much more dominant factor in the acquisition of corporate bonds than the life insurance industry is in Canada. To this extent therefore the Canadian investment dealer has

a more complex distribution problem than his U.S. competitor.

38D. Table III-A, pointing out that 35 per cent of Canadian corporate and other bonds are in the hands of non-residents, indicates the desirability of access to foreign capital markets if the investment dealer is to continue to fulfill his functions of raising capital funds for business enterprise.

UNDERWRITING COSTS

39. The cost of issuing securities varies according to two main factors -- size and degree of risk. With regard to size there are certain expenses involved such as legal fees, preparation of prospectus, research and sales expenses which are more or less fixed regardless of the size of an issue. Thus the smaller the issue, the larger is the relative burden of these charges. In the matter of risk, the underwriter assumes a greater chance of loss on securities of small or new companies, or those with unstable earnings records, than with, for example, a well established utility; the chance of loss is also greater in the underwriting of junior securities, particularly common stocks, than in the case of first mortgage bonds. These factors account in large measure for the differences in costs shown in the following table, derived from reports submitted by members of the Investment Dealers' Association.

TABLE IV

	Number of Members Reporting	Percentage: Arithmetic Average	Percentage: Median	Percentage: Range
Average gross mark up (as a per cent of cost) on -				
Common stock issues -				
(a) under $3 million	24	8.43	9.09	2.00 - 14.00
(b) over $3 million	7	6.98	6.38	5.00 - 10.00
Preferred stock -				
(a) under $3 million	14	6.05	4.77	3.50 - 11.11
(b) over $3 million	6	4.75	4.00	3.50 - 6.50
Bonds and Debentures				
(a) under $3 million	33	4.62	3.90	1.00 - 10.00
(b) over $3 million	20	2.82	2.85	.50 - 5.00

COMPARISON WITH THE UNITED STATES

40. In general, and this belief arises in good part from our experience in joint underwritings with U.S. firms on Canadian issues, we would say that costs are very similar in the two countries, but generally somewhat higher in Canada for large issues and somewhat lower for small issues. A study by the Securities and Exchange Commission in 1957 produced the following data:

TABLE V

United States Underwriter's Compensation % of Gross Proceeds of New Issue (1951, 1953 and 1955).

$ millions) Size of Issue	Common Stock	Preferred Stock	Bonds, Notes, Debentures
under .5	27.15%	-	-
.5 .9	21.76	12.63	11.49
1 - 1.9	13.58	8.07	8.17
2 - 4.9	9.97	4.88	3.78
5 - 9.9	6.17	3.72	1.83
10 - 19.9	4.66	2.92	1.52
20 - 49.9	5.37	3.20	1.33
50 and over	-	2.51	1.19

N.B. The percentages given above are the arithmetic averages in each classification.

41. The data in Table V are subdivided into more classes than the information requested from members of the I.D.A. and show clearly the tendency for underwriting costs to decline with the size of the issue and the type of security issued. Other data in the S.E.C. study also show a correlation between the size of the issuing company and the underwriting costs.

42. In comparing Table IV with Table V, it must be noted that the former is the gross mark up as a percentage of cost, whereas the latter is expressed as a percentage of the issuing price. If the Canadian data were on a comparable basis with the U.S., the percentage would therefore be somewhat lower. Even so, it is apparent that in issues of under $3 millions underwriting costs are lower in Canada than in the U.S., (in the case of common stock particularly they are

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($ millions) Size of Issue	Common Stock	Preferred Stock	Bonds, Notes, Debentures
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.5 - .9	[illegible]	12.63	[illegible]
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significantly lower), while for larger issues they are a point or so higher.

43. Further support for this conclusion can be found in a comparison of the spread between yield to buyer and yield cost to company of utility issues rated by Moody's. In 1959 and 1960 such spreads on issues by U.S. utilities rated by Moody's as BA or BAA ranged from .0 per cent to .17 per cent; issues of Canadian utilities with similar ratings in recent years have had spreads ranging from .11 per cent to .17 per cent (in both cases the issues surveyed were in excess of $15 million). A further sample of large issues of well regarded Canadian companies, but not rated by Moody's, showed spreads from .16 per cent to .18 per cent. In this comparison we have used "yield spread" as this was the information supplied in Moody's Public Utilities Manual.

44. There are, of course, fundamental differences in the nature of the markets in the two countries. The very size of the major financial institutions in the United States makes it possible for issues even as large as $50 million to be placed with only a handful of buyers and retail distribution of bonds to individuals is the exception rather than the rule. In Canada, by contrast, most issues are sold to a large number of institutions and individuals. The costs of distribution are therefore considerably higher in this country, and do not fall as rapidly with size as in the United States.

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COMPETITIVE BIDDING versus NEGOTIATED SALES

45. The comparison between comparable U.S. and Canadian utilities in Paragraph 43 is interesting for in many cases U.S. utilities are compelled by the regulatory authorities to call for competitive bids on new debt security issues, whereas in Canada the practice amongst non-Government companies is to have negotiated issues with fiscal agents.

46. The theory behind competitive bidding in new issues, as with other types of contract, is that competition is likely to result in the most favourable price to the seller. In some instances this probably holds true. There is reason to believe, however, that this may not be so in the case of security issues, judging by the experience in the United States.

47. From the data supplied in Moody's Public Utility Manual, a comparison was made of negotiated sales and competitive tenders, taking issues with the same rating, issued at roughly the same time of year (i.e. within the same month) and of approximately the same size. In total, 16 comparable pairs of issues that fitted these requirements during 1959 and 1960 were found. In 11 of these comparisons both the yield to the public and the yield cost to the borrowing company were lower in the case of negotiated sales than in competitive bidding,while in 5 they were higher. The spread between yield to buyer and yield cost to borrower, representing the underwriting spread, was lower for negotiated sales in six comparisons, the same in 3 and higher in 7. With regard to the degree of difference,

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in the 11 cases where the yield cost to the borrowing company was lower for negotiated sales, the average difference from competitive bids was .29 basis points; in the five cases where competitive bids showed a lower yield cost, the difference averaged .11 basis points.

48. It would perhaps be unwise to draw strong conclusions from this limited survey, but there are good reasons why negotiated sales should in fact be cheaper for the issuing company than competitive bids. For a fiscal agent maintains a continuous relationship with a company. It is in a position to advise on the nature and timing of new issues, can assist in the preparation of the prospectus and can test the market ahead of time in order to ensure that the terms of the issue will be attractive to potential buyers, but not so attractive as to add unnecessarily to the borrower's cost. The fiscal agent tends to serve as an adviser in other matters relating to corporation finance, such as the temporary investment of funds and purchase of bonds for sinking funds, and also maintains markets for securities between issues. Where competitive bidding is followed, on the other hand, the terms of an issue are drawn up by the company, although sometimes a consultant is hired to advise on the issue and prepare supporting data, and dealers are required to bid on short notice without benefit of advance preparation and without a full and detailed knowledge of the company's position. Particularly when interest rates are on a rising trend, dealers therefore tend to allow fully for unforeseen problems when submitting bids.

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"Fundamentally, the contentions of government counsel on this and other phases of the case stem from a misconception of the investment banking business. And yet the advantages to an issuer, which are incidents of a continuing relationship with a good investment banker, seem too obvious for comment. In every business the customer feels that there are cogent reasons why he should continue with the firm which has rendered good service in the past. But with a series of security issues, the saving in the time and labour of the officers and employees of an issuer, which would have to be spent in teaching a new investment banker the intricacies of the business, and the financial set up of the company, are a matter of real consequence; and it must not be forgotten that many of the matters to be discussed are of such a character that company officials desire to have such conversations only with those whom they trust, and in whose integrity and competence they have complete confidence."

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AMORTIZATION OF UNDERWRITING EXPENSES

50. When a company issues debt securities, the usual practice is to capitalize the difference between the par value of the debt issued and the net amount received from the underwriters, and gradually write off the bond discount and expenses so created by appropriate charges to earnings over the life of the security or at once to earned surplus. Such charges, however, are not deductible from income for tax purposes. To the extent that the difference between par value and net receipts of funds represents the sale of bonds to the public at less than par value, it is reasonable that the amortization charges should not be tax deductible. But to the extent that it represents the underwriters' commission, we feel very strongly that it is fair and reasonable that the charges should be allowed as a deductible item, for the cost of raising funds is just as much a cost of doing business as, for example, the fee paid to an engineering consultant. We therefore suggest that the income tax legislation be amended so as to permit companies to deduct underwriting costs in arriving at taxable income.

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Companies Act, the Dominion Companies Act, the Ontario Corporation Information Act and the Quebec Companies Information Act. The movement towards bringing some uniformity and order to this mass of legislation is proceeding slowly but progress has been noted. For example, the provinces are currently studying a uniform Companies Act; four provinces now have identical, or nearly identical, Securities Acts, and it is understood that two other provinces are in the process of adopting very similar Securities Acts.

52. The Association has for some years been suggesting to provincial officials the advisability and the advantages to the provinces and the investing public of enacting uniform securities legislation and of administering such legislation in a uniform manner and observes that definite progress has been achieved in this regard. The Association recommends that steps should be taken whereby all provinces will expedite registration of new issues of investment securities on a uniform basis.

53. The Association has noted with interest a proposal that a Federal Securities Act and a Federal Securities Commission be established. The United States has two Federal Acts: The Securities Act of 1933, which is a full disclosure statute permitting the sale of a security provided specified information is given to the purchaser, and The Securities Exchange Act of 1934, which is primarily concerned with trading in securities after the primary offering. The 1934 Act regulates stock exchanges, the registration of brokers

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and dealers and imposes reporting, proxy and trading conditions relating to securities listed on stock exchanges. It should be observed that, in addition to these two Federal Statutes, 48 states also have securities legislation.

54. It would appear to the Association that if a Federal Securities Act and Commission were ever to come into being in Canada they would be superimposed on but would not replace the existing provincial securities legislation and commissions. The Association recommends that S.E.C. - type legislation not be established in Canada and that the Royal Commission take note of the progress which has already been achieved towards uniform securities legislation uniformly administered as well as the work in this connection which is presently in progress.

55. However, as the acts now stand, it is necessary that a complete prospectus be in the hands of a prospective buyer before an issue can be sold to him. Exceptions to this rule are the chartered banks, life insurance companies and trust companies. It would be helpful if the practice in the United States of using a "red herring" could be followed here. This is essentially a preliminary prospectus, with all the details except price and yield, which is distributed pending approval of the regulatory authorities. The institutions and other prospective buyers can study this at their leisure and indicate, subject to approval of the prospectus by the authorities and to the terms of the issue being satisfactory, how much they would be

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56. It would also be helpful if all regulations affecting the underwriting and sale of securities were promulgated to the Investment Dealers' Association, who would then inform all its members. At the present time, regulations are frequently not publicized and they are not discovered, or their import not fully appreciated, until the regulatory authorities bring them to the attention of an underwriter in a particular case. This, too, can result in delay in the scheduling of a new issue.

57. The expropriation of electric utilities by provinces have in the past and can in the future provide a heavy blow to the very foundation of Canadian justice. In the case of the B.C. Electric Company, the IDAC strongly asserted that in the interests of justice provision should be made for arbitration and independent appraisal of expropriated assets. It would seem desirable that insofar as is possible the justification for expropriating utilities should be removed. It thus seems essential that the Commission should give careful consideration to this question with a view to making a

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recommendation that the Federal Government do all that is in its power to devise means of removing the temptations to expropriate which arise out of the Federal Tax treatment of the provinces. Any such action would contribute to the restoration of the shaken confidence of Canadian and foreign investors in investing in electric utilities in particular and private industry in general.

58. In the matter of mergers and amalgamations there appears to be an absence of adequate safeguards to provide proper protection for what should be the rights of shareholders. Under conditions in which Canada is struggling to compete in world markets mergers may be desirable. As many Canadian businesses are small in comparison to their foreign competitors, certain mergers may well enable Canadian business to compete more efficiently and effectively and foster progress for this country. However, while recognizing the values of mergers or similar amalgamations when soundly conceived and properly organized, the IDAC deplores the so-called "take-over" technique when: (a) the identity of the buying principal is not disclosed; (b) the offer, if for less than 100 per cent of the voting stock, is not made proportionately to all shareholders; (c) the term of the offer is not sufficiently long to give all shareholders reasonable time to consider it.

59. Speaking generally, a company incorporated under the Companies Act of Canada is the natural vehicle to carry on a corporate enterprise in several provinces and is more attractive to foreign investors than a

recommendation that the Federal Government do all that is in its power to devise means of removing the temptations to expropriate which arise out of the Federal Tax treatment of the provinces. Any such action would contribute to the restoration of the shaken confidence of Canadian and foreign investors in investing in electric utilities in particular and private industry in general.

58. In the matter of mergers and amalgamations there appears to be an absence of adequate safeguards to provide proper protection for what should be the rights of shareholders. Under conditions in which Canada is struggling to compete in world markets mergers may be desirable. As many Canadian businesses are small in comparison to their foreign competitors, certain mergers may well enable Canadian business to compete more efficiently and effectively and foster progress for this country. However, while recognizing the values of mergers or similar amalgamations when soundly conceived and properly organized, the IDAC deplores the so-called "take-over" technique when: (a) the identity of the buying principal is not disclosed; (b) the offer, if for less than 100 per cent of the voting stock, is not made proportionately to all shareholders; (c) the term of the offer is not sufficiently long to give all shareholders reasonable time to consider it.

59. Speaking generally, a company incorporated under the Companies Act of Canada is the natural vehicle to carry on a corporate enterprise in several provinces and is more attractive to foreign investors than a

provincially incorporated company. However, the Act contains certain anomalies which tend to deter the incorporation of companies under its provisions and create unnecessary delays, expense and inconvenience in connection with the securities of companies which are incorporated under it. It is submitted that the Act should be reviewed with a view to elimination of these anomalies. In particular, it is recommended that private companies be permitted to offer their bonds and debentures to institutional investors, that the redemption and purchase for cancellation of preferred shares be simplified, that, in proper cases, companies incorporated under the Act be exempt from issuing and filing a prospectus in connection with the sale of their securities, that section 128, relating to the compulsory sale of shares, be repealed and that the Act be amended to permit amalgamation of Dominion companies either with other Dominion companies or with companies incorporated under the laws of any one of the provinces.

CORPORATION FINANCE

CONCLUSIONS AND RECOMMENDATIONS FOR THE I.D.A. BRIEF

References	
Para. 4,7, 8-11	Reflecting the importance of internally generated funds, which appear to have financed approximately 60 per cent of the total applications of funds of Canadian business during the period 1949-59, there has been very little weakening in the financial structure of business. Neverthe-less, the trend towards a higher proportion

of debt in the structure of capitalization is apparent. Among the factors influencing this is the high rate of corporate income tax, which provides an incentive for unsound financing.

Para. 40-44 — Underwriting costs appear to be lower in Canada than in the United States for small issues and somewhat higher for large issues. Because of the different nature of the markets in the two countries, distribution costs do not fall as rapidly with size in Canada as in the United States.

Para 50. — It is recommended that income tax legislation be amended so as to permit companies to deduct underwriting costs in arriving at taxable income.

Para.54 — It is recommended that S.E.C.-type legislation be not established in Canada and that the Commission take note of the progress already achieved towards uniform securities legislation uniformly administered and the work presently in progress to achieve this objective.

Para. 55 — It is recommended that the various securities acts be amended so as to permit the distribution of preliminary prospectuses in order that prospective buyers of a new issue can study it at length and indicate, subject to approval of the prospectus by the regulatory authorities and to the terms

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of the issue being satisfactory, how much they would be prepared to purchase. This practice is followed in the United States. It makes for a more orderly marketing of a new issue and gives the buyer more time in which to appraise it.

Para. 56 It is recommended that all regulations affecting the underwriting and sale of securities be promulgated to the Investment Dealers' Association, who could then inform its members.

Para.57 It is recommended that the Commission examine the important matter of expropriation of electric utilities with a view to recommending that the Federal Government devise means to minimize the temptation to expropriate arising out of Federal Tax treatment of the provinces.

Prar. 58 It is suggested the Commission examine shareholders rights in the light of certain recently employed "take-over" techniques.

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APPENDIX F

SECONDARY BOND MARKET

I N D E X

BRIEF OF THE TRADING FUNCTIONS COMMITTEE

For the purpose of this brief the following definitions will apply:

Broker	Member of a recognized stock exchange
Dealer	Member of the Investment Dealers Association of Canada or others such as Chartered Banks who participate in the secondary bond market.
Agent	Dealer who acts as a intermediary between buyer and seller at an established price and receives a commission for his services.
Principal	A dealer who accepts liability for his own account through either the purchase or sale of securities. It should be noted that dealers customarily act both as agent and principal but not in the same transaction and any purchase or sale must be designated as one or the other.
Money Market Dealer	One of 14 member dealers of the Investment Dealers Association to have been extended lines of credit by the Bank of Canada to facilitate their functions in the handling of Government of Canada Treasury Bills, and Government of Canada and Guaranteed Bonds with a maturity of less than 3 years.
Depth	The secondary market has depth when there are actual or easily accessible orders both above and below the current level of prices. A market lacking depth would be shallow.
Breadth	The secondary market has breadth when orders are in volume and from widely divergent groups of investors. A market lacking breadth would be narrow.
Resilience	The secondary market has resilience when new orders come into the market in volume in response to perceptible changes in yield. A synonym would be elastic and a market lacking resilience would be inelastic.
Thin	Describes a market which lacks depth, breadth and resilience.
Position	The liability which a firm has incurred in any security. The total of all

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Position	The liability which a firm has incurred in any security. The total of all

positions of a firm would make up that firm's inventory. A long position is one in which the firm has purchased securities for future sale. A short position is one in which the firm has sold securities which it does not currently own but which are to be purchased at a later date.

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I. THE NEED FOR A SECONDARY MARKET

1. It is inherent in the nature of a highly-developed capitalist society that there must be a mechanism by which capital may change hands. The process of transferring new capital from a saver to a user takes place in what is known as a primary market; while the transfer of outstanding (previously issued) securities from one investor to another takes place in the secondary market. In this brief we are concerned with the secondary bond market and will mention primary markets only where they impinge on the main subject.

2. The importance of the secondary market to the continuing development of the economy cannot be over-emphasized, for this market is a vital factor in regulating the smooth and efficient flow of funds from savers to users. There is no doubt that lack of secondary markets would increase the cost of capital and, by inhibiting the mobility of funds, reduce the ability of the country to finance its development from domestic sources.

3. Secondary markets provide two basic functions -- value perspective and liquidity -- on which the system depends for the orderly use of capital.

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3. Secondary markets provide two basic functions -- value perspective and liquidity -- on which the system depends for the orderly use of capital.

Through the secondary market, a level of prices is established which gives borrowers a reliable indication of the cost of capital and lenders an estimate of the rate of return they might expect from the type and terms of security being offered. This method provides the logical means of arriving at fair value for both parties. By establishing relative values at any point in time, secondary markets assist in establishing the order of preference in which prospective issuers will be allotted funds. The market is, therefore, an important factor in regulating the flow of capital throughout the economy.

4. The degree of liquidity which any new issue of bonds is likely to enjoy is second only to fair pricing in the minds of most investors. The secondary market provides the yardstick by which liquidity may be gauged from the behaviour of comparable outstanding issues. Investors having mandatory requirement for the return of cash at specific dates, purchase securities tailored to their needs. Others, who are unaware at time of purchase of future requirements for the return of cash, may purchase bonds having an intermediate or long term maturity in order to obtain the greater yield usually available. Conditions may arise whereby these investors desire to sell their holdings and the secondary market provides the means of so doing. Without liquidity, investors would be more reluctant to advance funds, borrowing costs would be substantially higher, and users would pay an unduly high price for capital. Markets also afford users the opportunity to

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carry out Sinking Fund and Purchase Fund operations at fair prices.

5. The importance of liquidity in reducing the costs of borrowing is made evident by comparison with mortgage rates in Canada. In the majority of cases, the cost of raising capital through a conventional mortgage is higher than that which would apply to an issue of bonds or debentures by the same issuer. Although other additional service charges must be considered, it is generally conceded that the higher interest cost of mortgages is largely due to the lack of an effective secondary market in which the investor may regain his funds for other purposes.

6. Open market purchases or sales by Bank of Canada in accordance with its interpretation of requirements for the conduct of monetary policy and other necessary movements of securities are greatly facilitated by the secondary market. Chartered Banks, Trust Companies, Corporations and individuals also rely on the market for portfolio adjustment.

7. The figures shown below compare total new bond issues in Canada during 1961 with the additional volume of secondary market sales made by members of the I.D.A.C. during their fiscal year. Not included are sales made by Bank of Canada, Chartered Banks or other participants in the secondary market.

TABLE I

Primary Market Sales vs. Secondary Market Sales, 1961 000's of Dollars

	Primary Market (1) Sales	Secondary Market (1) Sales
Treasury Bills	6,240,000	6,142,159 (4)
Canadas and Guarantees:		
under 3 years	1,325,000(3)	4,618,820
over 3 years	875,000(3)	1,961,748
Provincials and Guarantees:		
public sale	9,000	
parity & Savings bonds	204,645	
Municipals	462,180	368,087
Corporate, public sale	418,460	1,400,230
private sale	248,050	
	10,520,386	15,780,048
Less	1,015,000(3)	
	9,505,386	

(1) Source: Financial Post Record of Financing in 1961. (January and February, 1962).

(2) Source: I.D.A.C.

(3) Of the Primary Market Sales, the following gross amounts were taken by Bank of Canada and paid for by surrender of other maturing debt. Substantial amounts were later distributed to the public through the secondary market.

Canadas, under 3 years	$ 440,000,000
Canadas, over 3 years	$ 575,000,000
	$1,015,000,000

(4) Bills purchased by dealers at Thursday auctions are included. Purchase and re-sale agreements are not shown.

8. Although the secondary market sales of I.D.A.C. members only are shown, the total volume represents 166 per cent of primary market sales.

TABLE I

Primary Market Sales vs. Secondary Market Sales, 1961 000's of Dollars

	Primary Market(2) Sales	Secondary Market (1) Sales
Treasury Bills	6,240,000	6,142,159 (4)
Canadas and Guarantees:		
under 3 years	1,325,000(3)	4,618,820
over 3 years	575,000(3)	1,961,748
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public sale	9,000	
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Municipals	462,180	358,087
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Excluding Treasury Bills the figure would be 295 per cent.

9. It is of interest that approximately 95 per cent of the total recorded volume was handled by 33 dealers who carried inventories of over $1 million. If sales of Treasury Bills were excluded the proportion would be about 92 per cent. (Reference Table 3).

II. ORIGIN OF SECONDARY MARKETS IN CANADA

10. At the turn of the century there was to all intents and purposes no broad securities market in Canada and, in fact, as far as debt securities were concerned this condition existed up to the advent of the First World War. Prior to 1914 almost all Canadian capital requirements were met by imports from the United Kingdom and, after 1914, by imports from the United States. It was not until the U.S. market was restricted by the entry of the Americans into the war in 1917 that Canadians were faced with financing the major share of their own capital requirements. During the period prior to 1917 there were markets being made in Canadian debt securities in London and New York but lack of an efficient market system in Canada, coupled with poor communications, did not provide the domestic investor with a satisfactory means of buying or selling bonds. The Victory loans, first offered to the public in 1917, brought about the necessity for the establishment of a secondary market as a substantial volume of bonds had been placed domestically.

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in 1916 dealers in Montreal became interested in an association which resulted in the amalgamation of the two into the Bond Dealers Association of Canada. This group, the predecessor of the present I.D.A.C., originally consisted of 32 dealers from Montreal and Toronto. By 1919 the Association had grown to 72 members, including some from Western Canada and the Maritimes, and an active secondary market had begun to develop. This market developed actively during the 1920's and 1930's but was relatively stagnant during World War II. However, with the enormous expansion of the economy in the post-war period, the demand for capital grew very quickly, resulting in a highly-developed, vigorous secondary bond market.

III. THE SECONDARY BOND MARKET TODAY

(A) How Markets are Made

12. Those who normally participate in the secondary bond market as it is presently constituted are members of the I.D.A.C.; Trading Departments of the Chartered Banks and the Securities Department of Bank of Canada. In addition, members of the various Stock Exchanges in Canada and a number of other brokers and/or dealers licensed to deal in securities with the public by Provincial Securities Commissions may participate but experience has shown limited activity by these groups. The number in each category:

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TABLE 2

Members of th I.D.A.C.	185
Chartered Banks	8
Bank of Canada	1
Total	194
Members of Toronto, Montreal and Canadian Stock Exchanges (non I.D.A.C.)	45
Other licensed brokers and/or dealers, not included above (1)	200-250

(1) Source: I.D.A.C.

13. These dealers participate to a widely varying degree. The large majority makes use of the market only to execute orders obtained from clients and in most cases should therefore be described as agents. Others, while acting as agent in certain transactions, normally act as principals, buying and selling for their own account. From the results of a survey based on figures for 1961, presented in Table 3, there are 16 dealers who customarily maintained total positions in excess of $5,000,000 and 17 dealers whose positions were between $1,000,000 and $5,000,000. These dealers are, generally speaking, responsible for the origination and maintenance of secondary market levels. It is only through the willingness of such dealers to assume liabilities for their own risk that a continuing market without unduly sharp fluctuations can be achieved.

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TABLE 3

CATEGORIES OF MEMBERS OF THE I.D.A.C. - BY SIZE OF AVERAGE QUARTERLY INVENTORY FOR 1961

- INCLUDING RELATED SALES VOLUME

Average Quarterly Inventory	Federal Treasury Bills		Canadas & Guarantee Under 3 Years		Canada & Guarantees Over 3 Years		Provincial & Guarantees		Municipals, Schools & Hospitals		Corp. Bond & Deb. excluding Commercial Paper		TOTALS	
$	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol. M Mln $'s
0 - 24,999	168	36	133	99	128	186	133	107	139	44	119	94	65	187
25,000 - 99,999	-	-	14	30	20	97	19	25	22	46	38	85	35	138
100,000 -499,999	3	44	11	109	23	344	19	265	18	111	19	327	44	310
500,000 -999,999	-	-	9	178	6	259	5	171	4	77	2	47	8	161
1,000,000 -4,999,999	3	460	8	652	8	1076	9	721	2	90	7	827	17	1067
Over 5,000,000	11	5602	10	3551	-	-	-	-	-	-			16	14066
TOTALS	185	6142	185	4619	185	1962	185	1289	185	368	185	1400	185	15929
											Less Commercial & Finance Co. Paper			149
														15780

Source: I.D.A.C. Survey of Members, 1962

TABLE 4

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA
SUMMARY OF REPORTS BY MEMBERS
SCHEDULE B
INVENTORY OF FIXED INCOME SECURITIES HELD BY MEMBERS

Notes 1. This summary shows total inventory of fixed income securities held by Members during the calendar year 1961 on a quarterly basis.
2. Securities owned by firm and held outside of Canada are not included.
3. Unsold balances of new issues in primary distribution are not included.
4. Members' portions of joint accounts are included.
5. Inventory is shown in thousands of dollars.
6. Short positions are indicated by the letter (s) at left of figure.

Type of Security	33 Nat'l & other major positioning houses Inventory (thousands of dollars)					Remaining houses Inventory (thousands of dollars)					Total Inventory (thousands of dollars)				
	March 31,1961	June 30,1961	September 30, 1961	December 31, 1961	Average	March 31, 1961	June 30, 1961	Sept. 30 1961	Dec. 31 1961	Average	March 31 1961	June 30,1961	Sept.30 1961	Dec. 31 1961	Average
Fed. Treas. Bills	(s)5,235 103,703	155,299	(s)11,894 144,839	171,764	(s)4,282 143,900	50			100	38	(s)5,235 103,753	155,299	(s)11,894 144,839	171,864	(s)4,282 143,938
Cdas & Guar. of 3 yrs. or less	117,396	(s)1,148 97,460	(s)1,241 171,800	117,888	(s) 597 126,136	2,787	(s) 75 3,057	3,488	2,141	(s) 19 2,868	120,183	(s)1,223 100,517	(s) 1,241 175,288	120,029	(s) 616 129,004
Cdas & Guar. over 3 yrs.	(s)1,877 20,816	(s) 368 27,050	(s)3,697 23,583	(s)4,979 21,506	(s)2,729 23,236	(s)194 4,877	5,123	(s) 224 2,737	2,280	(s)105 3,756	(s)2,071 25,693	(s) 368 32,173	(s)3,921 26,320	(s)4,979 23,786	(s)2,834 26,992
Prov. & Guar.	23,249	(s) 125 11,852	(s) 184 25,347	26,850	(s) 76 21,824	(s) 9 3,774	(s) 15 1,801	(s) 5 4,075	(s) 18 3,304	(s) 12 3,238	(s) 9 27,023	(s) 140 13,653	(s) 189 29,422	(s) 18 30,154	(s) 88 25,062
Municip., school & hospital debs.	7,616	8,726	4,504	6,774	6,905	(s) 4 4,044	(s) 10 3,227	3,299	(s) 45 3,573	(s) 15 3,536	(s) 4 11,660	(s) 10 11,953	7,803	(s) 45 10,347	(s) 15 10,441
Corp. Bonds & Debs.	22,373	25,368	22,776	30,164	25,170	3,076	(s) 3 4,059	3,921	(s) 9 3,676	(s) 3 3,684	25,449	(s) 3 29,427	26,697	(s) 9 33,840	(s) 3 28,854
Finance & Commercial Paper	2,455	10,343	9,347	31,274	13,355	425	472	(s) 3 630	547	518	2,880	10,815	(s) 3 9,977	31,821	13,873
Total	(s)7,112 297,608	(s)1,641 336,098	(s)17,016 402,196	(s)4,979 406,220	(s)7,684 360,526	(s)207 19,033	(s) 103 17,739	(s) 232 18,150	(s) 72 15,621	(s)154 17,638	(s)7,319 316,641	(s)1,744 353,837	(s)17,248 420,346	(s)5,051 421,841	(s)7,838 378,164
No. of Members reporting			33					152					185		

Source: I.D.A.C. Survey of Members, 1962.

positions occur.

15. Over the years the efforts of dealers to achieve a proper mechanism for the handling of business has resulted in a program of careful selection and training of trading personnel, development and application of equipment, substantial expenditure for these facilities and the continual refinement of regulations and ethical practices. Each dealer employs from 1 to 21 trading personnel whose activities are related directly or indirectly to virtually all other departments and employees in the organization. The Trading Department may well be regarded as the nerve centre of a dealer's operations since advice must be sought in this area before any transaction of a primary or secondary nature can be completed.

16. A widespread system of branch operations has been developed by many dealers in Canada and some have established offices in the United States, Great Britain and Europe. Vast networks of private wires, private telephones and various public services are utilized to maintain constant contact with markets both national and international. This system of communications permits pertinent information and market changes to be available nationally within minutes with the result that an investor almost anywhere in Canada may keep abreast of current developments. Adequate and equal service is available almost simultaneously from coast to coast, allowing the industry to draw upon the savings of the nation. Customarily business may be conducted each business day between 9 a.m. and 5 p.m. in

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each of the time zones. During these hours traders are constantly in contact with other dealers to make their requirements and offerings known. By this method markets are made and matching transactions can be arranged.

17. Actions taken by the people responsible for making secondary bond markets result from their varying interpretations of the information which is available to them. Markets do not remain static for any prolonged period, as investors are constantly on the alert to anticipate changing conditions which may or may not come to pass but serve to stimulate market activity. In considering bond markets, price levels in themselves are not, generally speaking, of as much significance as the rate of return or yield to maturity. For this reason, prices for all categories of bonds, with the exception of those which carry special features, tend to move in the same direction when changes occur. This frequently results, when interest rates are tending higher, to create an oversupply of securities in the market. This oversupply situation is corrected only when investors feel prices have been reduced to an attractive level. Conversely, when interest rates appear to be working lower, supply dries up until a level is reached which appears in the minds of investors to warrant some liquidation. This process of adjusting yields to changing conditions is aided and moderated by those dealers who are prepared to anticipate such swings and to take positions for their own account. When a dealer has taken positions in certain issues and orders

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to buy or sell as the case may be are not forthcoming, he is frequently obliged to hedge his positions in other issues. In this way a determined effort is made to maintain stability. Dealers perform this function in anticipation of overall profitability in this area of their operations. Frequently, of course, losses are sustained through poor judgment or other factors beyond their control. The ability of dealers to hedge long positions is restricted by the limited number of financial institutions who make it a practice to lend bonds at reasonable rates. If a larger number of institutions would make bonds available at competitive rates for this purpose, the functioning of the market would be materially improved. Bank of Canada, Chartered Banks and Trust Companies have the necessary facilities to accommodate such borrowers. It is suggested that this practice be broadened and that dealers include the figures of such borrowings in their weekly report to the I.D.A.C.

(b) Regulation of Secondary Markets

18. There is relatively little direct legislative regulation of secondary bond markets when compared, for example, to the regulation of new issues and primary markets. That this area of trading in securities has not attracted restrictive legislation is indicative of the generally high level of integrity with which the dealers have conducted their business. Legislation has, however, been enacted which requires brokers, dealers and salesmen to be licensed before trading with the public.

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19. Over the years specific regulations concerning the trading of securities by members of the I.D.A.C. have been developed by the industry as are described in the Blue Book of the Investment Dealers' Association of Canada, Pages 426 to 434 inclusive. Failure to abide by the Regulations is subject to certain penalties as outlined in By-Law No. 8 of The Blue Book. In addition to the penalties for breach of the Regulations, the District and National Business Conduct Committees have broad powers to fine, suspend and/or expel any member (1) whose business conduct or practice is unbecoming a member or detrimental to the Association or (2) whose financial arrangements, associations or affiliations are objectionable.

20. In addition to the I.D.A.C. whose regulations govern trading by its members across the country, there are Bond Traders Associations in Toronto and Montreal. These Associations operate independently but in close conjunction with the I.D.A.C. and their Trading Regulations are now identical. The Chartered Banks do not hold membership in the I.D.A.C. but Trading Departments are members of the Bond Traders Association. Consequently, they conduct their business in accord with the I.D.A.C. Regulations. While members of the I.D.A.C. are customers of the Chartered Banks, the latter are also competitors in various areas of the bond business, raising a question of possible conflict of interest. Nevertheless, it is suggested that the Chartered Banks perform a useful service as participants in the secondary market. The Bond Traders Associations recommend changes

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in trading regulations to the I.D.A.C. as market conditions dictate, and it is very rarely that these suggestions are not acted upon by the senior body.

21. As evidence of the integrity of the participants in the secondary market, it is interesting to note that transactions customarily are made verbally, with written confirmation being received the day following that on which the business was done. It is seldom that any misunderstanding has occurred, but when this has happened between dealers, the Bond Traders Associations and the I.D.A.C. have been able to settle the matter quickly without reference to arbitration outside the Associations.

(c) Capital and Margin Requirements

22. The capital requirements for membership in the I.D.A.C. are stated in Appendix "A" of this I.D.A.C. brief. For those dealers who undertake liabilities of some consequence either for primary or secondary market operations, the need is substantial. A schedule of margin requirements, established to the satisfaction of the banking system, affords adequate protection to the lender for loans made to dealers against securities pledged. In addition to these minimum stipulations further specific liquid capital requirements must be maintained. This program is supervised by an established audit system and failure to comply is subject to certain penalties. Specific details of capital and margin requirements are contained in the I.D.A.C. Blue Book, By-Law Number 8A, pages 334-338 and Regulations pursuant thereto pages 405 to 412.

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(d) Characteristics

23. The character of the secondary market is conditioned by the supply and types of securities which are available for trading. The table following indicates the supply of Canadian debt securities as at December 31, 1961 by par value and the approximate number of individual issues.

TABLE 5

	TOTAL DEBT (1) in millions of dollars	NO. OF ISSUES (2)
Canada Treasury Bills	1,885	26
Canadas & Guarantees (ex savings bonds)	12,663	41
Provincials & Guarantees	8,190	700+
Municipals	3,960	4000+ (estimated)
Corporates	7,117	1000+ (estimated)
TOTALS	33,815	5767

Source: (1) Bank of Canada, Personal Communication, April, 1962.

(2) Various personal communications.

24. While there is a yield relationship which prevails throughout most categories of bonds, the trading characteristics vary from one class to another. The secondary market for Treasury Bills and Canadas under 3 years to maturity (the "Money Market") are covered in Appendix G of this I.D.A.C. brief and will not be discussed herein.

25. The volume of trading in Canadas and Guarantees maturing beyond 3 years is normally greater

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than in categories other than Money Market. In the earlier maturities of this group the market has reasonable depth and resilience but breadth is confined mainly to dealers, banks and other financial institutions. At present the longer end of the Canada market cannot be said to have normal depth, breadth or resilience. Such depth as does exist is provided mainly by the activities of the Securities Purchase Fund recently established by the Government. Reasons for this condition are dealt with in Section IV of this brief.

26. Provincial issues have good resilience and depth since unhibited factors of supply and demand determine market levels. There is a steady flow of new issues coming to market and at the same time Sinking Fund operations combined with regular investment demand create a relatively stable balance. Certain issues, particularly those of Ontario and Quebec, can be said to have breadth due to a broad public interest within those Provinces but others appear to be restricted, in the main, to an institutional market.

27. Municipal bonds are primarily sold in the form of serial issues which tends to limit secondary trading. Resale can be arranged, usually on an order basis, through those dealers who participate actively in the municipal market. In the few instances where term bonds exist, a generally favourable market is available.

28. The market for Corporation bonds has breadth and resilience. However, after the first flush of activity which follows primary issues, supply usually becomes difficult to obtain. If, in due course, some

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doubt is cast upon the credit of any issuer, a supply then becomes available and investment buyers are difficult to find until the situation is clarified. Such cases frequently produce a speculative interest resulting in active trading. Corporate bonds with special features, such as convertibility, warrants, etc., usualy have an active market depending on the performance of the associated equity.

29. It is interesting to note that in most circumstances the spread between bid and asked prices is relatively narrow. For example, in categories ranging from Government of Canadas maturing beyond 3 years through Provincials and Municipals to Corporates, the spread between the bid and asked price customarily ranges from 1/8 of 1 per cent to 1/2 of 1 per cent in the more actively traded issues. This is brought about by keen competition among dealers and results in investors of all classes having access to fair prices. It is felt that the market as a whole has reasonable depth, but on some occasions investors wish to move actively in a similar direction, creating difficulty in maintaining a narrow price range. This is termed a "one-way market". In such instances, dealers who are prepared to take positions help to alleviate the situation until such time as investment buyers or sellers can be found.

IV. SOME FACTORS AFFECTING SECONDARY MARKETS

External

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IV. SOME FACTORS AFFECTING BOND MARKETS

GENERAL

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Canada is a developing country, there has almost always been a greater supply of bonds available than there have been funds seeking investment. If, during the early years of development, Great Britain, and in more recent times the United States, had not supplied large amounts of capital for the purchase of fixed-interest bearing securities, our economy could not have expanded to the degree which has been reached. Since we have had to depend on imports of capital to supplement what we were able to generate internally, our interest rate structure originally followed the levels established in Great Britain, but for many years now has been more closely aligned to that prevailing in the United States. It is only natural, therefore, that interest rates in Canada be higher than those prevailing in the United States if funds are to be attracted to this market from time to time. While the trend of interest rates in Canada usually adjusts to the general pattern in the United States, following a reasonable interval, it does not seem likely that any regular spread in rates between the two markets can be established. This thesis is borne out by reference to Charts I and II. Definition of a regular spread would seem to be precluded as policies peculiar to one or other of the two countries are varied, producing changes in the attitude of investors.

Internal

31. With the influence of the American interest rate structure in mind, there are many factors of a purely Canadian nature which constantly have a bearing on the level of prices in our bond market.

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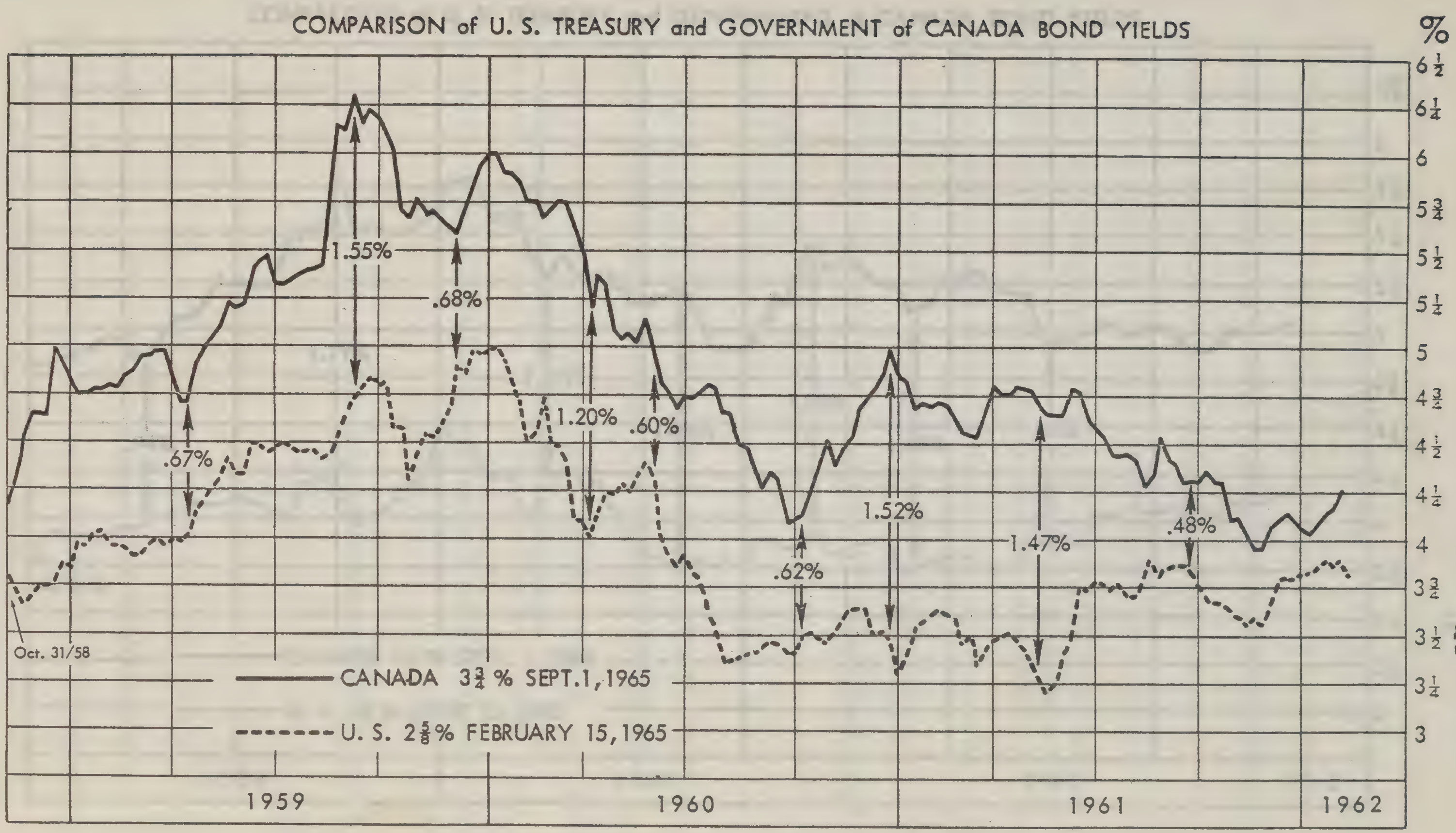
COMPARISON of U. S. TREASURY and GOVERNMENT of CANADA BOND YIELDS



A.400
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A.401
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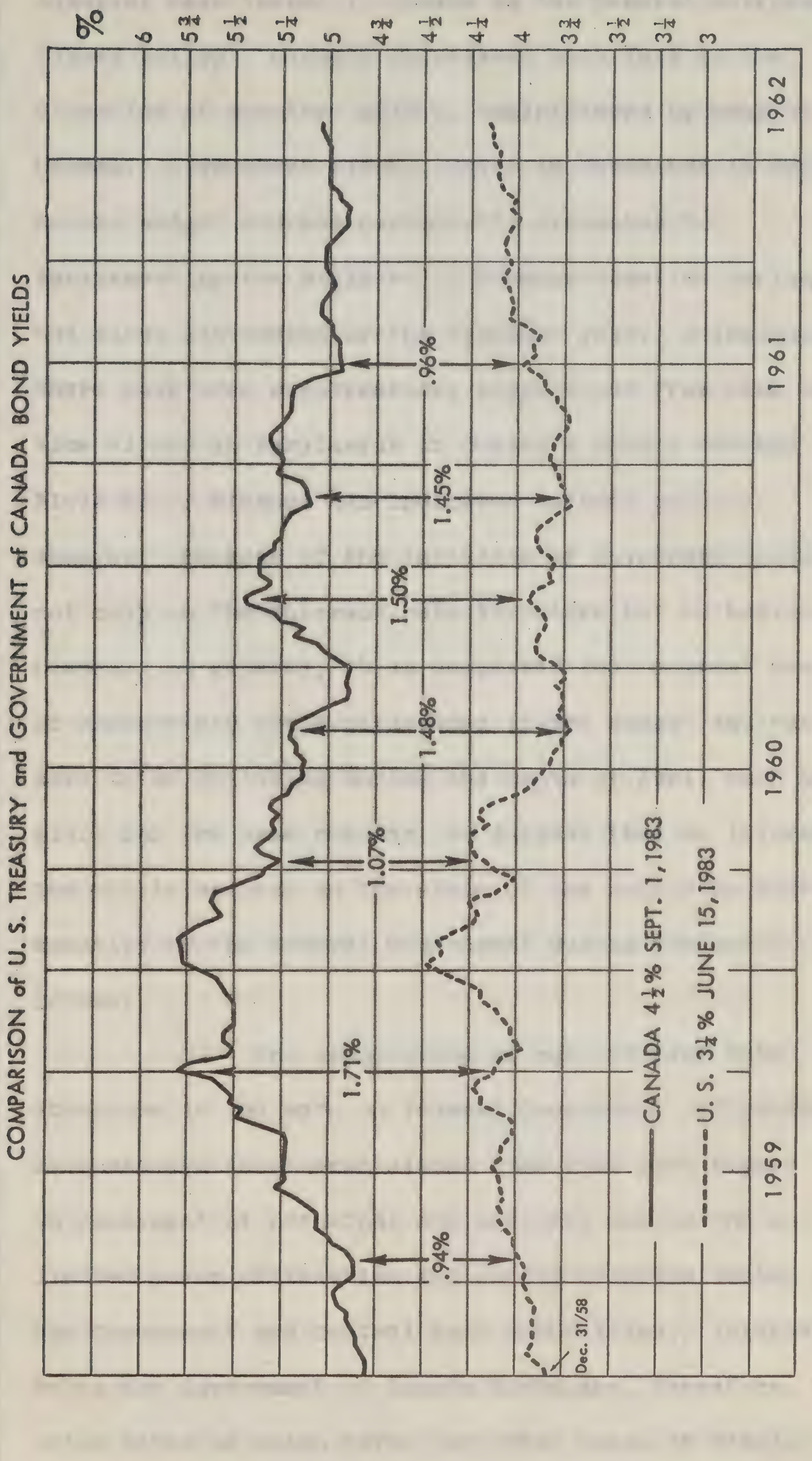
COMPARISON of U. S. TREASURY and GOVERNMENT of CANADA BOND YIELDS
%
6
5¾
5½
5¼
5
4¾
4½
4¼
4
3¾
3½
3¼
3
1962
1961
1960
1959
.96%
1.45%
1.50%
1.48%
1.07%
1.71%
.94%
Dec. 31/58
CANADA 4½ % SEPT. 1, 1983
U. S. 3¼ % JUNE 15, 1983

Probably the single most important factor relating to interest rate trends in Canada is the Federal Government's fiscal policy. Closely associated with this is the direction of monetary policy, administered by Bank of Canada. Government fiscal policy is described in the annual budget address customarily presented to Parliament by the Minister of Finance sometime during the first six months of the calendar year. Occasionally there have been supplementary budgets and from time to time either in Parliament or during a public address the Minister of Finance has indicated certain policy changes. Because of the influence of Government policy, not only on the interest rate structure but on business planning in general, it is suggested that a great deal of uncertainty would be avoided if the budget address were to be delivered during the month of April each year. Also, for the same reasons, we suggest that an informative public address on the state of the nation be made annually by the Federal Government during the month of October.

32. The cornerstone of our interest rate structure is the rate on Federal Government obligations as these are considered almost risk free with regard to repayment of principal and interest due to the unlimited power of taxation and credit creation vested in the Government and Central Bank authorities. Interest rates for Government of Canada Bonds are, therefore, the prime rates on which rates for other bonds of similar maturities are based and from which the others vary according to the credit rating of the borrower.

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33. During periods of economic recession and unemployment the practice of deficit financing for the purpose of revitalizing the economy has been generally accepted as a necessary social obligation. However, during the past 7 fiscal years ending March 31st, (1955-61 incl.) we have shown cash deficits in 6 years (with a small surplus in 1957) and the certainty of a deficit in the year ending March 31st, 1962. These deficits have occurred despite periods of prosperity which occurred during the years 1955-56, 1958-59 and 1961. These factors, together with the concurrent increase in money supply which has been necessary to finance the deficits, have done a great deal to destroy the confidence of investors in Government of Canada securities. Stability of price, which was the prime consideration in the minds of investors when they purchased Government of Canada securities, has been sharply reduced in this period. To take up the slack in Government financial requirements during recent years, the terms of the annual offering of Canada Savings Bonds have been expanded to the extent that a total amount in excess of 4 billion dollars is now held by the Canadian public. It would appear that the original intention of making this instrument available to the small saver and the payroll savings group has been discarded in favour of using the program as a means of obtaining funds on a volume basis.

34. The investor has also been encouraged by the 20 per cent dividend tax credit to become more interested in equities which are regarded as some

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protection against inflationary tendencies. While this has been beneficial to the financing of Canadian industry through equity issues, with an increasing volume of savings moving into the stock market, the private investor would seldom find himself in a position of wanting to purchase more than $10,000 of Government of Canada Bonds during the period of a year and this amount he has recently been able to obtain in the form of Canada Savings. These factors have tended substantially to reduce the number of private investors as buyers of Government bonds not carrying an early redemption privilege. Additional features concerning the Canada Savings program are discussed in Appendix B of this I.D.A.C. brief and mention is made of them here only to describe the influence which they have exerted on the breadth of the market for Government securities. The high level of taxation which has been reached, together with the erosion which has occurred in the purchasing power of our dollar, has tended to divert the interest of most investors away from Government of Canada securities and toward the higher yielding Provincial, Municipal and Corporation bonds. At the same time, the cost of capital to these more junior borrowers has been increased.

35. The institutional investor who, for one reason or another, must maintain a substantial portfolio of longer term bonds has reduced proportionately his holdings of Government of Canada Bonds and increased the other three categories. In other words, the professional investor regards those securities carrying

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continue indefinitely a program of debt monetization. Rates of interest on Government of Canada bonds set the standard for most other classes of bonds. It is obvious that a method to restore confidence in Federal Government securities is of major importance if markets are to be stabilized over the long-term and the general functioning of the economy is to be improved.

38. There are many technical innovations which might be introduced in an effort to re-establish confidence in Government securities. However, it is felt that most technical suggestions would probably tend to veer away from orthodox financing practices and would result in only artificial stability. The problem should be approached through a program which will improve the intrinsic value of Government bonds. It would seem, therefore, that the major factors for consideration would be:

1. A determined effort to hold government spending within a balanced budget during other than recessionary periods and that when deficit spending appears to be necessary, sincere effort be made to direct funds toward the areas which are most likely to produce growth.

2. A re-examination of the tax structure and a revision to an equitable level to produce greater incentive and growth without reducing revenues.

39. If the basic problem of lack of confidence

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2. A re-examination of the tax structure and a revision to an equitable level to produce greater incentive and growth [illegible].

39. If the basic problem of lack of confidence

could be satisfactorily resolved, the functions of the secondary market would help to establish a stable interest rate structure which would greatly benefit the conduct of the economy.

40. Bank of Canada re-discount rate should revert to a stated rate which would permit the authorities to indicate clearly the intended direction of monetary policy (see also Appendix "C"). This in turn should permit greater flexibility by the Chartered Banks in their administration of prime and call loan rates. These rates appear to have been somewhat higher than necessary during several protracted periods, which may have been brought about in an effort to compensate for the unrealistic limitation of 6 per cent during periods of monetary stringency. Call loans are supported by adequate collateral, providing prime credit for the Banks. Lack of flexibility by the Banks has driven borrowers to non-bank lenders thus narrowing the market by permitting potential investors to escape liability while employing their funds profitably. It is also suggested that non-bank lenders may not always be equipped to supervise these loans as effectively as the Chartered Banks. Nor does this procedure permit the monetary authorities and others to have proper knowledge of borrowing activity.

41. Income tax rates and the income against which the tax is assessed differ from one class of investor to another, as is indicated in Table 6.

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41. Income tax rates and the income against which the tax is assessed differ from one class of investor to another, as is indicated in Table 6.

TABLE 6 Approximate Tax Rates

Some Canadian Investors	Coupon %	Capital Appreciation %
Chartered Banks	50-53	50-53
Trust Companies, capital account	50-53	nil
guaranteed account	50-53	50-53
Insurance Co.'s - Life, mutual	nil	nil
Life, shareholder-owned	50-53*	nil
General	50-53	nil
Pension Funds	nil	nil
Mutual Funds - mutual	23	nil
- growth	50-53	nil
Estates and Trusts	14-80	nil
Charitable, Religious & Fraternal Organizations	nil	nil
Individuals	0-80	nil
Non-financial Corporations	50-53	nil
Provincial & Municipal Governments	nil	nil

* on that part of income which is transferred to shareholders' equity. This amount is set actuarially.

These approximate tax rates may be modified by rulings of taxing authorities according to individual circumstances.

42. In order to maximize after-tax income, the requirements of one investor will vary from those of another in a different tax classification. For example, an individual in the higher tax brackets would

TABLE 6 Approximate Tax Rates

Some Canadian Investors	Coupon %	Capital Appreciation %
[illegible]	[illegible]	50-53
[illegible] account	50-53	nil
guaranteed account	50-53	50-53
Insurance Co.'s - Life, mutual	nil	nil
[illegible] owned	50-53*	nil
General	50-53	nil
Pension Funds	nil	nil
Mutual Funds - mutual	23	nil
- growth	50-53	nil
Estates and Trusts	14-80	nil
[illegible] & Fraternal Organizations	nil	nil
Individuals	0-80	nil
Non-financial Corporations	50-53	nil
Provincial & Municipal Governments	nil	nil

* on that part of income which is transferred to shareholders' equity. This amount is set actuarially.

These approximate tax rates may be modified by rulings of taxing authorities according to individual circumstances.

[illegible]

[illegible] of another in a different tax classification. For example, an individual in the higher tax brackets would

be more interested in a low interest bearing security selling at a discount from par than in a high interest bearing security selling at par or at a premium over par, since he pays no income tax on capital appreciation. Conversely, pension funds, which are not taxable as to either income or appreciation, would be interested in the highest yield whether from a large coupon or from a substantial discount. As many investors are in a position to benefit greatly from non-taxable capital appreciation, bonds selling at a discount normally are in demand and trade on a lower yield basis than do higher coupon bonds. Hoever, despite the lower gross yield such discount bonds usually provide a higher after-tax yield. Specific examples of the foregoing generalizations are shown in Table 7.

TABLE 7

Examples of Gross and After-Tax Yields

- tax rate taken as 50 per cent on interest income.

Issuer	Coupon	Maturity	Price %	Gross Yield %	After-tax Yield %
Prov.of Ont.	3%	Oct.1977	80.25	4.80	3.10
Prov.of Ont.	6%	Nov.1979	106.75	5.36	2.52
Canada	3¼%	June,1976	83.25	4.89	3.08
Canada	5½%	Oct,1975	103.25	5.17	2.47

43. Differences in the length of time to maturity play an important part in the requirements of various classifications of investors. Some, such as Banks, Trust Companies and most non-financial corporations, are generally interested in short term securities as a high degree of liquidity is required for most of

be more interested in a low interest bearing security selling at a discount from par than in a high interest bearing security selling at par or at a premium over par, since he pays no income tax on capital appreciation. Conversely, pension funds, which are not taxable as to either income or appreciation, would be interested in the highest yield whether from a large coupon or from a substantial discount. As many investors are in a position to benefit greatly from non-taxable capital appreciation, bonds selling at a discount normally are in demand and trade on a lower yield basis than do higher coupon bonds. Hoever, despite the lower gross yield such discount bonds usually provide a higher after-tax yield. Specific examples of the foregoing generalization are shown in Table 7.

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- tax rate taken as 50 per cent on interest income.

Issue	Coupon	Maturity	Price $	Gross Yield %	After-Tax Yield %
Prov. of Ont.	3%	Oct. 1977	80.25	4.60	3.10
Prov. of Ont.	6%	Nov. 1979	106.75	5.36	2.52
Canada	3½%	June, 1976	83.25	4.89	3.06
Canada	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

43. Differences in the length of time to maturity play an important part in the requirements of various classifications of investors. Some, such as Banks, Trust Companies and most non-financial corporat-ions, are generally interested in short term securities as a high degree of liquidity is required for most of

their funds. Others are usually prepared to invest in mid to long term securities although for particular reasons, such as an anticipated decline in the market, they may invest some of their funds in short term securities.

44. Bond issues for which Sinking Funds or Purchase Funds have been established normally have a more favourable market than term bonds without these provisions. The annual requirements of such funds, affording underlying purchasing power in the market coupled with consequent debt reduction prior to maturity, creates broad investor confidence. Bonds issued with stipulated instalments maturing each year over the term of the obligation (serial bonds) are commonly sold to investors who do not contemplate re-sale. As a result, the secondary market for such bonds is not active although, through negotiation, other purchasers can usually be found. Bond issues which are sold by way of private placement to a limited number of financial institutions are not as a rule actively traded in the secondary market. As in the case of serial bonds, the investor purchases such issues with the intention of holding until redemption. However, new investors can usually be found should the original investor care to liquidate his holding.

45. Bonds carrying special provisions, such as convertibility into common stock, warrants to purchase stock and/or a bonus of common shares, trade in the secondary market at prices which bear greater relation to the performance of the underlying equity than to the

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normal interest rate structure. Convertible bonds, for the period of convertibility (which commonly is less than the full maturity of the bond), usually trade at a premium over the related value of the underlying equity. When the warrant or bonus features have been detached, or when convertibility has expired or lacks current value, the market for such bonds develops in line with the normal interest rate structure, having regard to the credit rating of the issuer.

V. RELATIONSHIP OF BANK OF CANADA TO SECONDARY MARKETS

46. Bank of Canada has Securities Representatives situated in its offices in Toronto and Montreal who maintain contact with the Investment Industry. Transactions may normally be arranged through them for the account of the Bank between the hours of 10:00 a.m. and 3:30 p.m. Transactions on behalf of others for whom they are acting may be arranged during the trading hours of 9:00 a.m. and 5:00 p.m. When the Bank has an interest in any specific issue either as principal or agent, its policy is to consider firm offerings and firm bids. Infrequently an immediate reply may be forthcoming, but on most occasions approval must be obtained from the main office of the Bank in Ottawa. Delays of up to several hours are not uncommon causing considerable uncertainty to the market. As Bank of Canada is an important and generally active participant in the secondary market, it is recommended that a program of expediting reply be implemented.

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V. RELATIONSHIP OF BANK OF CANADA TO SECONDARY MARKETS

46. Bank of Canada has Securities Representatives situated in its offices in Toronto and Montreal who maintain contact with the Investment Industry. Transactions may normally be arranged through them for the account of the Bank between the hours of 10:00 a.m. and 3:30 p.m. Transactions on behalf of others for whom they are acting may be arranged during the trading hours of 9:30 a.m. and 4:00 p.m. When the Bank has an interest in any specific issue either as principal or agent, its policy is to consider firm offerings and firm bids. Infrequently an immediate reply may be forthcoming, but on most occasions approval must be obtained from the main office of the Bank in Ottawa. Delays of up to several hours are not uncommon causing considerable uncertainty to the market. As Bank of Canada is an important and generally active participant in the secondary market, it is recommended that a program of expediting reply be implemented.

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implement monetary policy, to adjust portfolio, to act on behalf of Purchase Fund and Government accounts, and more recently to redistribute certain new issues which it has accepted in whole or in part at time of issue. Consideration of methods used in distributing new issues is presented in Appendix "B" of this I.D.C.A. brief. However, the type of issue which is more or less continuously available to investors ("a tap issue") is harmful to the free operation of market forces as it effectively establishes a ceiling on prices or may well lead to overspeculation by dealers in their efforts to fully purchase, i.e. "clean up" the total issue. The market would function more effectively if substantial portions of all such issues were offered to the public at advertised prices and it is recommended that this policy be followed in future.

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50. There is doubt that the Central Bank should act as agent for Government accounts and Purchase Fund as this seems to centralize a disproportionately large amount of the total funds which are actively in the market. Such accounts might be handled by the Department of Finance or by establishing separate trading functions for each account, thus reducing possible conflict with monetary policy.

51. It is recognized that many dealers and others have become accustomed to the present operations of the Bank and spend a great deal of time in trying to anticipate the Bank's policy. Inevitably some of such judgments prove to be incorrect and many have been prone

implement monetary policy, to adjust portfolio, to act on behalf of Purchase Fund and Government accounts, and more recently to redistribute certain new issues which it has accepted in whole or in part at time of issue. Consideration of methods used in distributing new issues is presented in Appendix "E" of this I.D.C.A. brief. However, the type of issue which is more or less continuously available to investors ("a tap issue") is harmful to the free operation of market forces as it effectively establishes a ceiling on prices or may well lead to overspeculation by dealers in their efforts to fully purchase, i.e. "clean up" the total issue. The market would function more effectively if substantial portions of all such issues were offered to the public at advertised prices and it is recommended that this policy be followed in future.

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to find fault with the Bank for not following the course which they had anticipated. If the above suggestions were implemented such people would be obliged to rely upon their own judgment and could not blame the monetary authorities for their own errors.

VI. MARKET DATA, AVAILABILITY AND ADEQUACY

52. In the normal course of events there is much statistical data which is regularly referred to in assessing market behaviour. For example, the weekly Financial Statistics provided by Bank of Canada enable those interested to keep abreast of many important factors. The Investment Dealers Association gathers and makes available to its members statistics relating to their overall non-bank loaning position. The Association also provides the press with a regular service covering the more actively traded issues. Individual dealers supply the public with quotation sheets, money market statistics, general market comment, specific bids and offerings, and a flow of general information. The Dominion Bureau of Statistics supplies much useful statistical information. The Department of Trade and Commerce publishes reports on the Outlook for Private and Public Investment in Canada. In addition to these sources of information which are readily available, there are a number of statistical and/or forecasting services available in Canada whose information and projections are useful in predicting future yield trends.

53. Information relating to Central Bank action in the market and the reasoning behind such action would enable the market to function more smoothly. At present,

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the only detailed comment available on the Bank's actions and objectives is contained in its Annual Report. A regular report similar to the Monthly Review of the Federal Reserve Bank of New York or the Quarterly Review of the Bank of England would be helpful to market participants.

VII. CONSIDERATION OF A BOND EXCHANGE

54. From time to time, the question has arisen as to whether an organized Bond Exchange would provide better operating results than are now available through the dealer secondary bond market. There are some aspects of an organized exchange which might be beneficial but it is submitted that the present system, which has evolved over the years, is best suited to meet the requirements of bond trading.

55. Some of the advantages of an exchange operation would appear to be the recording of volume and price changes and establishment of a focal point which might attract greater participation by the general public. However, bond quotations are readily available and volume figures would have little meaning since one major transaction would far outweigh, in its influence, any number of small transactions. The equity market is representative of almost every type of private industry and, while the market generally may be moving in one direction, special considerations may cause some stocks to move against the prevailing trend. This divergence of trends is not a factor in bond markets, since in most cases prices are based on yield. Individual price changes are, therefore, not significant since

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arbitrage quickly adjusts discrepancies.

56. The level of bond yields is largely developed by those professionals who manage substantial portfolios. The price at which the small investor may deal is, as a result, usually established by the major investor and provides the former with the safeguard of professional judgment. Furthermore, dealers who position bonds usually complete such transactions at net prices in line with institutional prices and consequently the private individual completes his business at a minimum of cost. If an organized bond exchange were established to replace the over-the-counter market, substantial costs for additional facilities would be required. The added cost of these facilities would have to be borne by the public in the form of established commissions. As an example, a dealer would regard a spread of 1/2 of 1 per cent, or $50 on a $10,000 corporation bond transaction in the secondary market, as reasonable compensation. Under stock exchange commission schedules, a $10,000 transaction in shares of the same company selling at $50 would cost the investor $80.

57. An exchange-type transaction requires the matching of off-setting orders with the broker acting as agent. However, due to the size of many bond transactions it would be unusual at any given time to find that matching orders existed. In recognition of this, dealers have organized themselves to assume liabilities, thus providing the service required without revealing the size and scope of orders. In the secondary

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bond market, the problem of investors moving in the same general direction frequently presents difficulties and these would be greatly aggravated by disclosure of transactions on an organized exchange market.

58. Bonds are traded on the New York Stock Exchange but only in relatively moderate volume. It is noteworthy that in the report of the Joint Congressional Committee's, "Study of the Dealer Market for Federal Government Securities" (Washington, 1960), it is stated that in 1958 only $1.4 billion in bonds were traded on the N.Y.S.E. vs. $176 billion of sales of Federal Government Securities alone through the dealer market. The latter figure does not include corporate, state and municipal bonds for which the volume of transactions through the over-the-counter market is not available. It is also notable that while bonds are traded through the London Stock Exchange, volume and prices of transactions are not published. Bonds, which formerly were traded on the Montreal Stock Exchange, have not been traded there for over 10 years and bond transactions on the Toronto Stock Exchange in 1961 aggregated only $14,435,000 of which $11,250,000 were Treasury Bills. For comparison, the approximate total volume of bond trading by members of the I.D.A.C. in the over-the-counter market in Canada during 1961 was in excess of 15 3/5 billion (Ref. Table 1).

59. It would seem, therefore, that the investing public in Canada can be best served at the lowest cost by the present system. A similar conclusion regarding the necessity of a dealer market

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for bonds has been reached in a study of the United States market. (Roosa, Robert V. - "Federal Reserve Operations in the Money and Government Securities Markets Federal Reserve Bank of New York 1956, page 34).

VIII RECOMMENDATIONS

Reference to Text		
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32	17	1.) Yields on Government of Canada securities are the foundation of our interest rate structure. Recurring
33	17	deficits coupled with inflationary increases in the money supply and other
34	17 & 18	factors, have severely damaged the confidence of investors in Government securities and thus threaten the whole
35	18	market for fixed income bearing securities. To restore confidence in Government securities and stabilize the interest
37	18 & 19	rate structure it is strongly recommended that: (a) a determined effort be made to balance the Federal Budget

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(b) 38 19 the nation's tax structure be examined and revised in order to produce greater incentive and growth throughout the economy.

2.) The information presently available
52 24 to the secondary market is, for the main part, adequate for investment decisions. However, there are areas in which
31 14 & 17 actions and policy of the Federal Government are not clearly stated. It is suggested that implementation of the following recommendations would materially aid dealers and investors in assessing Government influences on the secondary market and would assist in re-establishing confidence in Government securities.

(a) Deliver the Federal Budget during the month of April each year.

(b) Deliver an annual informative public address on the state of the nation during the month of October.

3.) Bank of Canada, as agent for Government accounts and as the administrator of monetary policy, is one of the most important factors in the secondary

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40 20 (a) Bank of Canada re-discount rate should revert to a stated rate thus indicating the direction of monetary policy.

46 22 & 23 (b) The Bank should implement a program designed to expedite reply to firm bids and offerings, thus removing one cause of uncertainty in the market.

48 23 (c) "Tap issues", which are more or less continuously available to the market, are harmful to the free operation of market forces. Substantial portion of such issues should be offered to the public at advertised prices at the time of issue.

50 23 (d) In order to decentralize some of the funds in the market and to avoid possible conflicts with monetary policy, Government accounts and Purchase Fund should be handled by the Department of Finance or separate trading agencies.

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50	27	(d) In order to [illegible] of the funds in the market and to avoid possible conflicts with monetary policy, Government [illegible] and Purchase Fund should be handled by the Department of Finance or separate trading agencies.

(e) A practice of issuing regular quarterly reports by Bank of Canada, similar to the Monthly Review of the Federal Reserve Bank of New York or the Quarterly Review of the Bank of England, would aid the market's understanding of the Bank's actions and objectives.

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APPENDIX G

SHORT-TERM MONEY MARKET

Contents

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Contents

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SHORT-TERM MONEY MARKET BRIEF

I. FORMATION AND GROWTH

(1) The money market in Canada had its earliest beginnings in 1934 when 91-day Treasury Bills were first sold by tender. The number of issues increased progressively and by 1937, tenders were held every other week and in 1953 a weekly tender was introduced. During this period, the Chartered Banks were the principal buyers and only occasional trades took place between the banks and the Bank of Canada. The banks did not trade with each other. Investment dealers performed a very limited role at this time, but they occasionally tendered for Treasury Bills on behalf of clients or purchased bills from the banks against orders. During the early nineteen fifties, certain dealers carried modest amounts of Treasury Bills in inventory and this increased as the Bank of Canda at the same time increased its market spreads and allowed the dealers further scope for their operations.

(2) Early in 1954, the Bank of Canada agreed to give certain dealers limits or lines of credit by which Treasury Bills could be discounted at the Bank under a sales repurchase agreement. This privilege was made available at a lower interest rate than that charged by the Chartered Banks under their call loans in order to encourage the dealers to trade in bills and carry an inventory. The market began to develop quickly from this point and the eligible paper was expanded to short-term Government of Canada bonds and guarantees maturing within three years. Thirteen dealers received lines of

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credit at the Bank of Canada and since that time the number has varied between twelve and the present fourteen. The names of the money market dealers, on March 31, 1962, are given in Exhibit "A".

(3) The next important step occurred in June 1954 when the first day-to-day loans were made by the Chartered Banks to the money market dealers. It was felt that if the money market dealers were to carry substantial inventories of bills and short governments, it was necessary that they should be able to finance these inventories at relatively attractive rates and low margin requirements to create reasonable incentives. The creation of the day loans provided the banks with a highly liquid earnings asset and allowed them to make the fullest possible use of other funds. The day loans were designed so that they could be called by either party prior to 12 o'clock on each business day. During the first week, the day-loan rate was set at 1½ per cent, and thereafter the rate varied in response to monetary conditions. As a further aid, the banks agreed to communicate through an exchange broker the latest rates established on any transaction to one million or more. The Chartered Banks further co-operated by reducing their overcertificates charge from 1/100 of 1 per cent ($100 per million) to 1/250 of 1 per cent ($40 per million).

(4) A significant change in the monetary system accompanied the formation of the short-term market. Through an amendment in the Bank Act, the banks were required to hold a cash reserve of 8 per cent,

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whereas prior to this a 5 per cent reserve had been mandatory, although in fact the banks had tended to hold a 10 per cent reserve for liquidity purposes. Consequently the foregoing adjustment immediately made available approximately $200 million of investible funds. During this time, the Central Bank was carrying out an easy-money policy and, therefore, the money market in Canada developed quickly with the banks showing good demand for money market securities. The dealers built up an inventory and began to call active markets.

(5) In November and December 1955, the Bank of Canada "urged" (Bank of Canada Annual Report 1955, page 16) the Chartered Banks to adopt a policy of maintaining cash and secondary reserves equal to 15 per cent of Canadian deposit liabilities. Secondary reserves at that time were defined as comprising of Treasury Bills and day-to-day loans. The banks were still required to maintain 8 per cent of cash against deposit liabilities. The banks accepted the suggestion of the Bank of Canada and since May 31, 1956 have maintained secondary reserves above their required amount. This agreement, although somewhat restricting the Chartered Banks' operations, has allowed the banks to make minor adjustment to their cash position through the day-loan market without having to buy or sell Treasury Bills.

(6) In 1957, the banks eliminated the over-certification charges on money market transactions relating to the day-to-day banking of short-term securities. From that time on, it was possible for dealers to move their inventory from one bank to another,

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(7) The Bank of Canada added another facility which greatly assisted the dealers in doing business outside of Toronto and Montreal. This was an arrangement whereby the Central Bank would release bonds at no cost to the dealer at any one of the Bank's nine agencies across the country; and after January 1957, any dealer could hand in bills or short bonds at any agency of the Bank of Canada, who would arrange to release the same securities the same day at any other agency of the Bank. Also during 1957, the use of Bank of Canada (same day) funds were eliminated, except in relation to withdrawals and deposits of currency and the making or repayment of advances. All other transactions were settled in clearing house (next day) funds. (Bank of Canada Annual Report).

(8) Since 1954, the money market has expanded greatly and the term "money market" now embraces many transactions not related to Government of Canada short-term obligations. The money-market dealers have actively worked towards extending facilities of the market to meet the requirements of both borrowers and lenders. The various short-term obligations now in the money market will be discussed in detail in this report.

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and maintain an active trading market. Since dealer inventory nearly always exceeds the capital of the firm, it is necessary to borrow money to pay for the securities by assigning the securities to the lender as collateral for a loan. Initially most dealer loans were arranged with the Chartered Banks; however, some repurchase or buy-backs were arranged with investors as a convenient way of providing the exact maturity date in cases where Treasury Bills and other short-term obligations did not have a suitable maturity date. The security used in the repurchase agreement would normally be only slightly longer than the term of the repurchase so that the market liability of the dealer was kept to a minimum. The repurchase agreements were, in effect, equivalent to a security term loan and these transactions played a considerable part in introducing non-bank corporate and institutional investors to dealer loans. For short-term investors, these secured loans to the dealers became a convenient way of employing temporarily idle funds without taking any market risk. The range of collateral has broadened to include the obligations of provinces, municipalities and corporations. The dealer found that the ability to offer buy-backs to accounts was often a valuable means of establishing business contacts and, as a result, inventory was often carried for the purpose of servicing these accounts. The role of the dealers, therefore, began to resemble more closely that of the London Discount Houses. The dealers took on the role of loaning money to both governments and corporations by owning their securities in inventory while

borrowing funds from non-bank lenders to finance the inventory. This aspect of the money market was described in the Radcliffe Report. (Committee on the Working of the Monetary System Report,page 58). "They earn their living mainly by borrowing money more cheaply than they lend it and, to some extent, from commissions and jobbing profits. They borrow for shorter periods than the periods of commitment in lending, (they 'lend short' but borrow even 'shorter').....".

(10) The dealer, by owning securities to give as collateral for repurchase loans as well as trading, provides an active market in short-term securities giving continuity and stability to the money market. The study of the dealer market for federal government securities, prepared by the Joint Economic Committee of the Congress of the United States, (United States Government Printing Office, Washington, 1960) states on page 94 that "the growth of repurchase agreements during the post-war years has played an important role in making the money market more efficient. Through repurchase agreements, the existence of higher interest rates is brought to the attention of small banks and non-financial corporations. Undoubtedly this has led to a more rapid adjustment by the private economy to the effects of changes in the supply of money and credit, and to a reduction of the time lag between introduction of a policy and the effectiveness of the policy". The dealer fulfills the role of a banker inasmuch as temporarily idle cash can be put to work for extremely short periods of time. The question of statistics and controls of

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dealer non-bank borrowing is discussed under the section on "Country Banks."

II. INSTRUMENTS IN THE MARKET

(a) Government of Canada Treasury Bills

(11) Treasury Bills are currently offered weekly by the Bank of Canada, acting on behalf of the Government, through a competitive tender. There are no restrictions on who may tender, but the Chartered Banks, money-market dealers, and the Bank of Canada are the principal bidders. Sealed tenders are submitted to the Bank of Canada and are opened at 12 o'clock noon on Thursdays (except when holidays intervene). The Treasury Bills are awarded on the basis of price until the whole issue has been allotted. Frequently a bidder will submit half a dozen or more bids at different prices and only the highest of these will be accepted. Generally the total bids received from the banks and investment dealers, excluding the Bank of Canada, are for a greater amount of bills than those being offered so that all bids will not be successful. The Bank of Canada will also bid in competition with the others. It is the normal practice for the Bank of Canada to submit a reserve bid for the entire amount of each issue, in order to guard against a situation in which the tenders of other bidders might not be sufficient to subscribe for the entire issue. (In England, "since the beginning of the Second World War, it has been agreed by the discount houses who are members of the London Discount Market Association that the total of their bids will always cover the tender." -Radcliffe Report, page 39 - Commercial banks do not

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tender directly for Treasury Bills in England). At approximately 2:00 p.m. on the day of the tender, each participant receives a telephone call from the Bank of Canada giving the following information:

(i) Number of bills won

(ii) High, low and average tender for each maturity offered

(iii) Total amount and maturity of bills to be tendered for on the following week.

(12) Since May 6, 1959, both 91-day and 182-day Treasury Bills have been offered. During the latter part of 1954 through November 1955, 273-day bills were offered. The following table shows the distribution of Treasury Bills as at December 31, 1961.

HOLDERS OF GOVERNMENT OF CANADA TREASURY BILLS

(Detailed statistics as to the holders of Government of Canada Treasury Bills since 1954 will be found in Exhibit "B".)

(In $000,000)

As at December 31, 1961	Amount	%
Bank of Canada	298	(16)
Chartered Banks	1,172	(62)
Government Accounts	8	(--)
General Public	408	(22)
TOTAL	1,886	(100)

(13) The statistics obtained by the Investment Dealers' Association indicate that members of the Association held an inventory of $171,864,000 in Treasury Bills at 1961 year end, or 9.1 per cent of the Treasury Bills outstanding. As can be seen from the above table, the Chartered Banks are the principal owners of Treasury Bills and the main market for the dealer.

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The dealer, as mentioned earlier, will often carry Treasury Bills as inventory so that repurchase agreements can be entered into with particular accounts.

(14) The Chartered Banks tender for bills each week for their own account and provide the principal market for Treasury Bills in Canada. Inasmuch as they have to compete at the tender, they do not always obtain their full requirements and have to purchase bills in the market. Dealers from time to time enter into pre-tender contracts with the Chartered Banks, in which they agree to confirm to the bank a stated amount of bills at the average tender yield, less .02 per cent in basis.

(15) At certain periods in the past when Canadian Treasury Bill yields were well above those prevailing in other countries and the cost of foreign exchange hedge was not prohibitive, bills were sold to non-residents. The introduction of the 15 per cent withholding tax on Treasury Bills, instituted on March 16, 1961, reduced the sale to non-residents substantially. The withholding tax is calculated in such a manner as to prove more discriminating to non-residents than a 15 per cent withholding tax would imply. (See Exhibit "C" regarding calculation of withholding tax on Treasury Bills.)

(b) Short-Term Government of Canada and <u>Government of Canada Guaranteed Bonds</u>

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HOLDINGS OF GOVERNMENT OF CANADA BONDS
(See Exhibit "D" for holders of Government of Canada bonds maturing two years and under, from 1954 to 1961).
(OF A MATURITY TWO YEARS AND UNDER)

As at December 31, 1961	Amount ($000,000)	%
Bank of Canada	514	(16)
Chartered Banks	1,089	(34)
Government Accounts (est.)	60	(2)
General Public	1,503	(48)
TOTAL	3.166	(100)

(17) The Investment Dealers' Association statistics indicate that dealers held $129,004,000 of short-term bonds, maturing within three years and under, in their inventory positions as of December 31, 1961. Information relating to holdings of the money-market dealers alone is not available.

(18) The long maturities issued by the Government (excluding C.N.R.) since the conversion loan of September 1, 1958 were all, with the exception of one issue, sold to the Bank of Canada for resale to the public. The long market has been relatively thin for government bonds, while the money market has grown rapidly so that funds appear to be available to satisfy most

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short-term borrowers at the present time. During the past few years, the Government has been particularly concerned about borrowing its cash requirements in the short-end of the market, as can be illustrated by the Minister of Finance's statement in the Budget of April 10, 1962:

> "In my Budget speech last June, I said that in order to avoid congestion in the long market, we would for at least several months confine new federal issues to short-term bonds. During the past nine months, we have issued no long-term bonds; 375 million ranging in term from 5¼ to 6 years were placed directly with the Bank of Canada, and the terms of all other market issues in no case exceeded 3½ years."

(19) One factor which should be mentioned regarding the question of financing the short-term debt of the federal government is that of competing for corporate surplus funds. Corporations, being subject to both federal and provincial taxes, are most attracted to securities offering the highest net or after-tax yield. Therefore, a low-coupon and high-discount bond, which will have a certain portion of tax-free capital appreciation, is relatively attractive. There has been a strong incentive by borrowers to issue low-coupon, deep-discount securities in the past. However, the Budget of December 20, 1960, imposed the following restrictions:

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"that where the contractual rate of interest on any bond, debenture, or similar evidence of indebtedness, issued by a tax-exempt borrower, is less than 5 per cent, and where the bond or debenture is issued at a discount which provides an effective yield to maturity or to the earliest call date that exceeds the contractual rate by more than one-third, the whole discount shall be deemed to be income in the hand of the first Canadian resident taxable holder of the instrument."
(See page 1011 Hansard, December 20, 1960.)

Prior to this legislation, coupons of as low as 1½ per cent were used by all levels of Government and corporations alike in raising funds in the short-term market.

(20) An exception to this practice of raising money on low-coupon notes was the introduction, in the issue of October 1, 1959, or $250 million Government of Canada 5½ per cent, October 1, 1962, convertible at the holder's option at any time prior to June 30, 1962, into 5½'s October 1, 1975. This issue attracted considerable attention from both corporate and institutional investors. Since that time, an additional $100 million, 5½ per cent of October 1, 1962, were offered and $448 million 5½'s, April 1, 1963, convertible into 5½'s, due April 1, 1976.

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(21) There are no restrictions on the investment dealers that can trade in the market in either Treasury Bills or short Government bonds. The various bond traders associations have established regulations relating to trading, which set the minimum size of trading at $100,000, in order to provide a flexible and responsive market. The trading rules relating to the money market sector, laid down by the Toronto Bond Dealers' Association, are given in Exhibit "E".

(c) Bankers Acceptances

(22) Preliminary work has been done by both the Chartered Banks and money-market dealers, in conjunction with the Bank of Canada, in examining the possibility of an Acceptance market in Canada. The banks must initiate this new development by being prepared to "accept" corporate paper for a set fee. It is expected that the money-market dealers would be able to bank such paper in the day-loan market provided by the Chartered Banks and that it would, at some point, be eligible for rediscounting at the Bank of Canada. The dealer would be a jobber on such Acceptances and it is thought that the banks would be the principal buyers of the paper. Acceptances, as they are presently visualized, would provide the investor with a rate of return somewhat between Treasury Bills and prime finance paper. At the present time, certain questions of taxation have held up the introduction of Acceptances.

(d) Provincial and Municipal

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(21) There are no restrictions on the investment dealers that can trade in the market in either Treasury Bills or short Government bonds. The various bond traders associations have established regulations relating to trading, which set the minimum size of trading at $100,000, in order to provide a flexible and responsive market. The trading rules relating to the money market sector, laid down by the Toronto Bond Dealers' Association, are given in Exhibit "E".

(c) <u>Bankers Acceptances</u>

(22) Preliminary work has been done by both the Chartered Banks and money-market dealers, in conjunction with the Bank of Canada, in examining the possibility of an Acceptance market in Canada. The banks must initiate this new development by being prepared to "accept" corporate paper for a set fee. It is expected that the money-market dealers would be able to bank such paper in the day-loan market provided by the Chartered Banks and that it would, at some point, be eligible for rediscounting at the Bank of Canada. The dealer would be a jobber on such Acceptances and it is thought that the banks would be the principal buyers of the paper. Acceptances, as they are presently visualized would provide the investor with a rate of return somewhat between Treasury Bills and prime finance paper. At the present time, certain questions of taxation have held up the introduction of Acceptances.

(d) <u>Provincial and Municipal</u>

(23) 1) <u>Provincial</u> - The provinces have been attracted to the short-term market to meet some of their

requirements for funds. Although they have been traditionally borrowers in the long-term market, they have found that the developing short term money market can provide them with a flexible source of funds to help meet their total requirements. The money market has provided them with a means of selling provincial Treasury Bills (Manitoba and Saskatchewan), short-term low-coupon bonds for periods of usually two years or less, and parity bonds. Parity bonds compete for short-term funds when the rates are attractive and when no restrictions are placed on the amount sold to any one purchaser.

(24) D.B.S. statistics provide some information with regard to provincial short-term debt outstanding and issued during the fiscal year, but this does not include securities issued by authorities and guaranteed by the provinces. Both British Columbia and Alberta have been very active in financing some of their requirements through provincial-guaranteed short-term securities.

(25) The dealer syndicates formed to underwrite the long-term borrowing needs of the provinces usually do not prohibit the dealer from negotiating directly with the provinces for securities of two years and under. Therefore, a considerable amount of short-term financing by the provinces has been arranged privately and little information is available. However, some provinces, notably Alberta and British Columbia, have called for tenders on particular blocks of short-term maturities and dealers, in this case, will either

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tender alone or form a group to tender on a particular offering.

(26) The majority of provincial short-term bonds are offered as low-coupon as possible, under the restrictions described on page A.433, paragraph 19. Short-term provincial bonds do not trade actively. Therefore, the owner of such investments, having to value them on a regular basis, will usually receive a theoretical valuation which is not subject to swings in the market.

(27) ii) Municipal - A number of municipalities, including such names as Metro Toronto, cities of Toronto, Montreal, Hamilton, Winnipeg, Vancouver, London, Kitchener and Kingston, have already taken advantage of the short-term money market. Most municipal borrowings are designed to meet current expenditures prior to tax receipts being received, and often allows them to choose the most favourable time for financing in the long market.

(28) The larger municipalities call for tenders on their short-term obligations; however, some are arranged on a negotiated basis. Inasmuch as most municipal short-term borrowings are relatively small, dealers act independently and are not normally restricted by syndicates when tendering for short-term offerings.

(29) Little information is available to indicate the amount of municipal short-term debt arranged during the past few years. However, it would appear that during the first quarter of 1962 in

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excess of $35,000,000 was borrowed by municipalities in the short term market.

(e) Finance Company Paper

Sales finance companies raise a substantial percentage of their borrowing requirements in the money market. Prime finance companies, including such names as General Motors Acceptance Corporation, Industrial Acceptance Corporation, Limited, Traders Finance Corporation, etc., borrow for terms of one year or less at somewhat similar rates. These rates are sensitive to the supply and demand of short-term money and are usually accurate indications as to the availability of such funds. Second-line finance companies will pay rates often up to 1/2 of 1 per cent more in order to meet their borrowing requirements.

(31) The amount of finance paper outstanding at the present time might be estimated to be in excess of $500 million. (The Federal Council of Sales Finance Companies estimate that the ten largest finance companies had short-term obligations during 1961 of between $410 million and $525 million.)

(32) Dealers act as agents on behalf of the finance companies and receive a commission for locating purchasers of this paper. At certain times, dealers will inventory this paper, but by doing so must find suitable "country bank" accommodations to carry it. I.D.A. statistics indicate that dealers were carrying inventory of $31 million in finance company and corporate paper on December 31, 1961.

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(f) Corporate Paper

(33) This sector of the money market has attracted considerable attention inasmuch as it has grown very rapidly and is a development that was not visualized in 1954. Corporate paper has shown this growth for several reasons. The cost of corporate borrowings from the Chartered Banks has been relatively high compared with the availability of short-term money, and the corporate paper, itself, has found a ready market with short-term investors. This is largely true because corporations do not establish fixed rates at which they will sell their paper and each is perfectly free to choose whatever term or rate they think is necessary to attract money. Therefore, the senior credits can compete actively with finance companies through small variations in rates paid. Corporate paper is also issued on a "demand" basis by which the investor purchases a liquid investment at a fixed rate of return. This paper can be called on 24-hour notice by the purchaser, or in some cases by both parties, and has become very attractive to investors at times when the immediate outlook for short-term rates is uncertain. The corporation borrowing through 'demand" paper also receives the advantage of obtaining funds at the lowest possible rate. The return on "demand" paper is closely related to the day-to-day money rate and the 30-day prime finance paper rate.

(34) Corporate borrowers in the money market include retail stores, oil companies, grain merchants, chemical manufacturers, breweries, distillers, and many others. These companies have been attracted to the money

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market primarily due to the relatively high cost of borrowing at the Chartered Banks at the prime rate. Exhibit "F" illustrates the spread between the prime rate and the cost of 3-day money for a senior corporation paper since 1959.

(35) It is expected that companies using the money market for a certain part of their borrowing requirements will have bank lines of credit available to cover any amount of paper outstanding and, in most cases, companies continue to borrow a certain amount from their banks.

(36) Like many segments of the money market, there is little or no statistical information available. A survey of the larger borrowers as to their authorization to borrow in the short-term market indicates that, at any one time, there could be up to $450 million corporate paper in the market. However it is more likely that the actual borrowings by corporations would range between $275 million and $325 million at present.

(37) As the money market grows, there are an increasing number of corporations of many kinds borrowing in the short-term market, and it becomes more difficult for the purchaser of the paper to be selective and have time to examine the credit standing of each name. It is important that, if the paper market is to grow in a responsible manner, the buyers be fully aware of the credits they are purchasing. This is especially true as a large volume of paper is sold on a "demand" basis and perhaps not enough attention is paid to the name of the borrower.

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(38) The dealer normally acts as an agent in selling corporate paper and receives a smaller commission than that paid by finance companies. Although the commissions are small, the dealer often feels that establishing contact with the corporation to offer short-term paper can, in the long run, be most rewarding.

(g) Deposits

(39) i) Chartered Banks - The banks recently established set rates at which they will accept deposits for terms of up to one year. These rates have tended to be 1/4 of 1 per cent below those offered by the prime finance companies but, on some occasions, the rates have competed with finance company paper. These deposits are often particularly attractive to those restricted to trustee investments. One bank issues deposit certificates for terms of one to six years at a published rate. These certificates can be transferred and have some measure of liquidity. The bank pays dealers a commission for placing these medium term certificates.

(40) The banks will also accept deposits in U.S. dollars at their American agencies. The Canadian banks compete among themselves for U.S. dollar deposits and do not keep to any uniform rate schedule. The banks are not restricted by regulations of the Federal Reserve Board as to the rate that may be paid on deposits of one year and under in the United States and, as a result, the Canadian banks have attracted a large number of deposits from both American institutions and corporations. The banks will also compete, between

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ii) Trust Companies

(41) Trust companies issue deposit receipts which are non-transferable. Some provincial accounts, municipalities and corporations, restricted to trustee investments place their short-term funds with the trust companies on deposit.

(42) The dealers play a considerable role in helping the trust companies obtain deposits, and in some cases the trust companies will pay a commission for deposits obtained at a specified rate. However, it is more usual for the trust company to accept a deposit if a suitable offset investment can be arranged. This involves the dealer originally locating the client, agreeing on a rate at which the trust company deposit would be attractive, then offering the trust company an offset investment (finance or corporate paper, etc.) at 1/4 to 1/2 of 1 per cent higher than the deposit rate. Some trust companies pool all their short-term investments in a central fund and accept deposits at rates based on their over-all short-term earnings. Since the banks have become more aggressive in seeking

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(h) Export Finance Corporation of Canada Limited

(43) Another recent issuer of short-term paper is the Export Finance Corporation of Canada Limited, which is wholly owned by Canada's eight Chartered Banks. This corporation borrows money in the short-term market in order to assist mid-term (one to five years) financing for exports which have been insured by the Export Credits Insurance Corporation, a Crown company. Most of the notes which have been sold by the Export Finance Corporation of Canada Limited have been payable in U.S. dollars for periods up to 180 days, and have been bought by the Chartered Banks directly from the Corporation. However, dealers have placed $16 million with clients other than the Chartered Banks as of March 31, 1962. Short-term U.S. pay paper of Export Finance Corporation is subject to a 15 per cent withholding tax.

III. PARTICIPANTS

(a) Bank of Canada

(44) i) Dealer Lines of Credit - Money-market dealers, as mentioned earlier, have lines of credit with the Central Bank which allow them to enter into repurchase agreements with the Bank to finance their inventory of Treasury Bills and Government of Canada money-market securities when other sources of accommodation are not available. Thus, the Bank of

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(45) ii) Bank Rate - There has been much criticism directed at the variable Bank Rate since its introduction on November 1, 1956. Elsehwere in the I.D.A. brief, there is an expression of opinion that a floating Bank Rate, calculated weekly at a rate of 1/4 of 1 per cent above the average price tendered for 91-day Treasury Bills, gives little guidance to the market as to the Bank of Canada and Government policy. However, it is the feeling of this committee that the variable Bank Rate is an important development in adapting the Canadian money market to our particular monetary system.

(46) Dealer inventories of money-market securities are normally financed through day-to-day loans at the Chartered Banks, and these day loans form the banks' most liquid asset next to cash. Therefore, when the Central Bank adjusts the cash in the banking system or a dislocation of cash between the eight banks takes place, the availability of day loans can vary greatly. Money-market dealers have been able to use their lines of credit at the Central Bank during these

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(47) However, should the Bank of Canada return to a traditional Bank Rate, then, because of the dependency of the money-market dealers upon the "lender of last resort" periodically, there should be an additional flexible rate similar to the floating Bank Rate so that money-market dealers could continue to operate and be protected by their lines of credit at a borrowing rate which is related to the current yields on Treasury Bills. This rate might be renamed "Bank Lending Rate" or "Bank Accommodation Rate."

(48) Dealers rediscounted securities, under the purchase and resale agreement with the Bank of Canada during 12 weeks of 1959, 17 weeks in 1960, and 11 weeks in 1961, according to the weekly statistics provided by the Bank of Canada.

iii) Market

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(50) The main criticisms concerning the trading operations of the Bank are:

(a) Decisions concerning most transactions are made in Ottawa and the Bank trader is usually given little or no discretionary powers.

(b) The Bank traders do not have direct "key" telephone lines to money-market dealers and Chartered Banks.

(c) One trader handles all sections of the Government market and does not have time to be fully acquainted with the factors influencing the money market.

(51) (iv) Statistical Information - The Bank of Canada publishes an excellent weekly and monthly series of statistics, as well as an annual summary, covering the Bank's, Federal Government's and Chartered Banks' operations. These figures are of particular interest to the money market because of information relating to the cash position of the banking system as

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(53) v) Loan of Securities - The Bank of Canada at one time was prepared to enter into a "reversible switch" arrangement for 30 days against suitable collateral. However, the rates charged appeared to be more than the market would bear and little use was made of this facility.

IV "Country Banks"

(54) The reasons for the development of "country banking" is given in Section I. of this report. As mentioned previously, the dealer is holding inventory to "bank" out for short periods of time, is following in the tradition of the twelve London discount houses

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Securities Banked by Members of the I.D.A. with the "Country Banks".

	($000,000)
Treasury Bills	72.4
Money Market	17.1
Canada's (three years and over)	9.7
Other Securities (not including stocks)	69.1
TOTAL	168.3

(56) In 1961, there were 11 weeks during which dealers banked over $100 million in Treasury Bills away from the banking system. Therefore, it can be seen that the "country banks" helped finance a considerable portion of the dealer inventories.

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V. NON-RESIDENT SHORT-TERM INVESTMENTS IN CANADIAN SHORT-TERM SECURITIES

(57) Non-residents have been active purchasers of Canadian short-term obligations over the past few years. Inasmuch as the Canadian dollar is not "pegged" and liable to wide swings, non-residents have been fully hedging their investments to eliminate any foreign exchange risk. It is usually possible to obtain forward exchange contracts for periods of up to one year. The fully hedged rate (the non-resident purchases Canadian dollars spot and sells forward at the maturity date of his investment) is dependent upon the cost or profit of hedging funds as well as the gross yield on the short-term obligation purchased.

(58) Prior to the introduction of the 15 per cent withholding tax on Treasury Bills, a considerable amount of Treasury Bills was sold abroad. Since that time, however, finance company and corporate paper has replaced Treasury Bills. This paper is also subject to a 15 per cent withholding tax deducted at maturity, but this tax is calculated and deducted easier than on Treasury Bills. In some cases, this resulted in the non-resident investor being introduced to alternative short-term investments in Canada that offered higher yields than those available on Treasury Bills. It should be remembered that short-term Government of Canada bonds,issued prior to December 20, 1960, are free of withholding tax to non-resident purchases.

(59) Short-term foreign flows of funds into Canada's money market on a fully hedged basis would

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(59) Short-term foreign flows of funds into Canada's money market on a fully hedged basis would

appear to have little influence on the factors affecting non-resident control of Canadian resources and manufacturing and, therefore, should not be subject to strong discrimination. However, the amount of non-resident ownership of money-market securities should be known in case restrictions are placed by foreign governments on their subjects investing funds outside their borders. At present, it is doubtful if any accurate figure of Canadian short-term paper owned by non-residents is known but an estimate of 300 - 350 million dollars might be made. This figure would include Treasury Bills, Government of Canada bonds, finance and corporate paper.

(60) Canadian banks from time to time actively solicit U.S. dollar deposits as described in the section on bank deposits. The rate of return accruing to the investor on these deposits is not subject to withholding tax.

(61) Canadian short-term investors will also place funds outside the country when foreign rates are attractive. Most investments of this sort are also made on a fully hedged basis. From time to time, the hedged rate of return on U.S. Treasury Bills or short-term paper becomes attractive largely due to the profit that can be made on hedging the investment.

[illegible]
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RECOMMENDATIONS

References

1) The money market performs an important function in contributing to Canada's economic development by helping to fully utilize all available sources of capital. It is, therefore, recommended that the money market should continue to receive the excellent support that it has obtained in the past from both the Bank of Canada and the Chartered Banks.

See Growth of Money Market.

2) The difficulty of obtaining accurate statistics for the preparation of a study on the money market illustrates the difficulty in assessing the roles of the various borrowers in the money market. It is recommended that more information be obtained and published concerning the borrowing by provinces, municipalities and corporations in the money market.

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6	16
9	24
10	29
12	36
16	49

3) Short-term foreign flows of funds into Canada's money market on a fully hedged basis would appear to have little influence on the factors affecting non-resident control of Canadian resources and manufacturing and, therefore, should not be discriminated against. The question of withholding tax on all short-term investments should be closely examined. 18 57

4) It is a recommendation that closer liaison be established between the Bank of Canada and the money- 15 49
market dealers for the purpose of trading in money-market 16 50
securities.

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4) It is a recommendation that closer liaison be established between the Bank of Canada and the money-market dealers for the purpose of trading in money-market securities. 15 49 16 50

EXHIBIT "A"

MONEY MARKET DEALERS RECEIVING LINES OF CREDIT AT THE BANK OF CANADA, AS AT MARCH 31, 1962.

Ames, A.E., & Co. Limmted

Burns Bros. & Denton Limited

Dominion Securities Corp. Limited

Equitable Securities Canada Limited

Gairdner & Company Limited

Greenshields & Company Inc.

Harris & Partners Limited

McLeod, Young, Weir & Co. Limited

Midland Securities Corp. Limited

Mills, Spence & Company Limited

Nesbitt, Thomson & Company Limited

Richardson, James, & Sons

Royal Securities Corp. Limited

Wood, Gundy & Company Limited

EXHIBIT "B"

HOLDERS OF GOVERNMENT OF CANADA TREASURY BILLS.

(In $000,000)

As at December 31st	1954	(%)	1955	(%)	1956	(%)	1957	(%)	1958	(%)	1959	(%)	1960	(%)	1961	(%)
Bank of Canada	169	(22)	264	(22)	507	(32)	469	(29)	36	(2)	309	(15)	407	(20)	298	(16)
Chartered Banks	363	(46)	430	(35)	743	(47)	808	(50)	956	(64)	983	(48)	974	(49)	1172	(62)
Gov. Accounts	41	(5)	36	(3)	40	(3)	59	(4)	89	(6)	30	(1)	56	(2)	8	(--)
General Public	208	(27)	494	(40)	285	(18)	289	(17)	415	(28)	755	(36)	549	(29)	408	(22)
TOTAL	781	(100)	1,224	(100)	1,575	(100)	1,625	(100)	1,496	(100)	2,077	(100)	1,986	(100)	1,886	(100)

EXHIBIT "C"

WITHHOLDING TAX ON TREASURY BILLS

An extract from House of Commons Debates, Vol. 105, No. 69, Official Report for Thursday, March 16th, 1961, page 3060, referring to an amendment to Section 108 of Bill C-73.

"This amendment provides that when a resident of Canads sells a Treasury Bill to a non-resident, the non-resident shall be deemed to have received a payment of interest. The amount of interest he shall be deemed to have received shall be equal to the proportion of the difference between the original issue price and the face value of the bill, that is, the proportion of the original discount, which is attributable to the unexpired portion of the term of the bill remaining at the time it is purchased by the non-resident.

"Since this amendment deems interest to have been paid to the non-resident at the time the non-resident purchased a Treasury Bill, the Canadian resident who sells the Treasury Bill will be obliged to withhold the 15 per cent non-resident withholding tax on the amount that is deemed to be interest.

"If, at some subsequent time before maturity, the non-resident sells

[illegible]

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"Since this amendment deems interest to have been paid to the non-resident at the time the non-resident purchased a Treasury Bill, the Canadian resident who sells the Treasury Bill will be obliged to withhold the 15 per cent non-resident withholding tax on the amount that is deemed to be interest.

"If, at some subsequent time before maturity, the non-resident sells

the Treasury Bill back to a Canadian resident, the non-resident will be eligible for a refund of that part of the tax he has paid which is attributable to the unexpired portion of the term of the bill."

EXHIBIT "D"

HOLDINGS OF GOVERNMENT OF CANADA BONDS
(OF A MATURITY TWO YEARS AND UNDER)

(In $000,000)

As at December 31st	1954	1955	1956	(%)	1957	(%)	1958	(%)	1959	(%)	1960	(%)	1961	(%)
Bank of Canada	1,193	1,021	520*	(24)	779	(31)	245	(11)	514	(18)	353	(16)	514	(16)
Chartered Banks	636	475	405	(19)	410*	(16)	826	(36)	657	(23)	615	(28)	1,089	(34)
Gov. Accounts (est.)	N.A.	N.A.	165	(7)	126	(5)	243	(10)	86	(3)	111	(5)	60	(2)
General Public	481	677	1,079	(50)	1,223	(48)	1,010	(43)	1,610	(56)	1,147	(51)	1,503	(48)
TOTAL	N.A.	N.A.	2,170	(100)	2,538	(100)	2,324	(100)	2,867	(100)	2,226	(100)	3,166	(100)

*Owing to changes in valuation procedures, these figures are not comparable with those of the foregoing year.

EXHIBIT "E"

TRADING REGULATIONS -- JANUARY 1, 1961

All transactions by dealers, whether acting in the capacity of either principal or agent, shall be as follows:-

2) There are no spread restrictions regarding trading of Government of Canada Bonds and Government of Canada Guaranteed Bonds having an unexpired term of one year or less to maturity, (or to the earliest call date where a transaction is completed at a premium).

3) All Government of Canada Bonds and Government of Canada Guaranteed Bonds having an unexpired term of over one year but three years or less to maturity (or to the earliest call date where a transaction is completed at a premium) shall be traded in multiples of five cents.

5) (a) Unless prefixed by some qualifying phrase, a dealer calling a market shall be obliged to trade Trading Units (as hereinafter defined), if called upon to trade;

(b) Any dealer asking thesize of a stated market must be prepared to buy or sell at least a Trading Unit (as hereinafter defined) at the price quoted if immediately requested to do so by the member calling the market;

(c) Trading Units shall consist of the following:

(i) In the case of Government of Canada direct obligations and Government of Canada

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Guaranteed obligations having an unexpired term of three years or less to maturity (or to the earliest call date, where the transaction is completed at a premium); $100,000 -- par value.

(ii) In the case of Government of Canada direct obligations and Government of Canada Guaranteed obligations, having an unexpired term to maturity of longer than three years (where a bond is traded at a premium the earliest call date shall be treated as the maturity date); $25,000 -- par value.

(iii) In the case of all other bonds and debentures other than Government of Canada direct obligations and Government of Canada Guaranteed obligations; $5,000 -- par value.

(iv) In the case of bonds and debentures issued with attached stock, warrants rights, or other appendages and traded in unit form; $5,000 par value of Bonds or Debentures, irrespective of the value of the appendages.

(v) In the case of common and preferred shares not listed on a recognized stock exchange (as defined in the Regulations of the I.D.A.)

-- in lots of 500 shares, if market price is below $1

-- in lots of 100 shares, if market price is at $1 and below $100

-- in lots of 50 shares, if market price is at $100 or above.

Nethercut & Young
Toronto, Ontario

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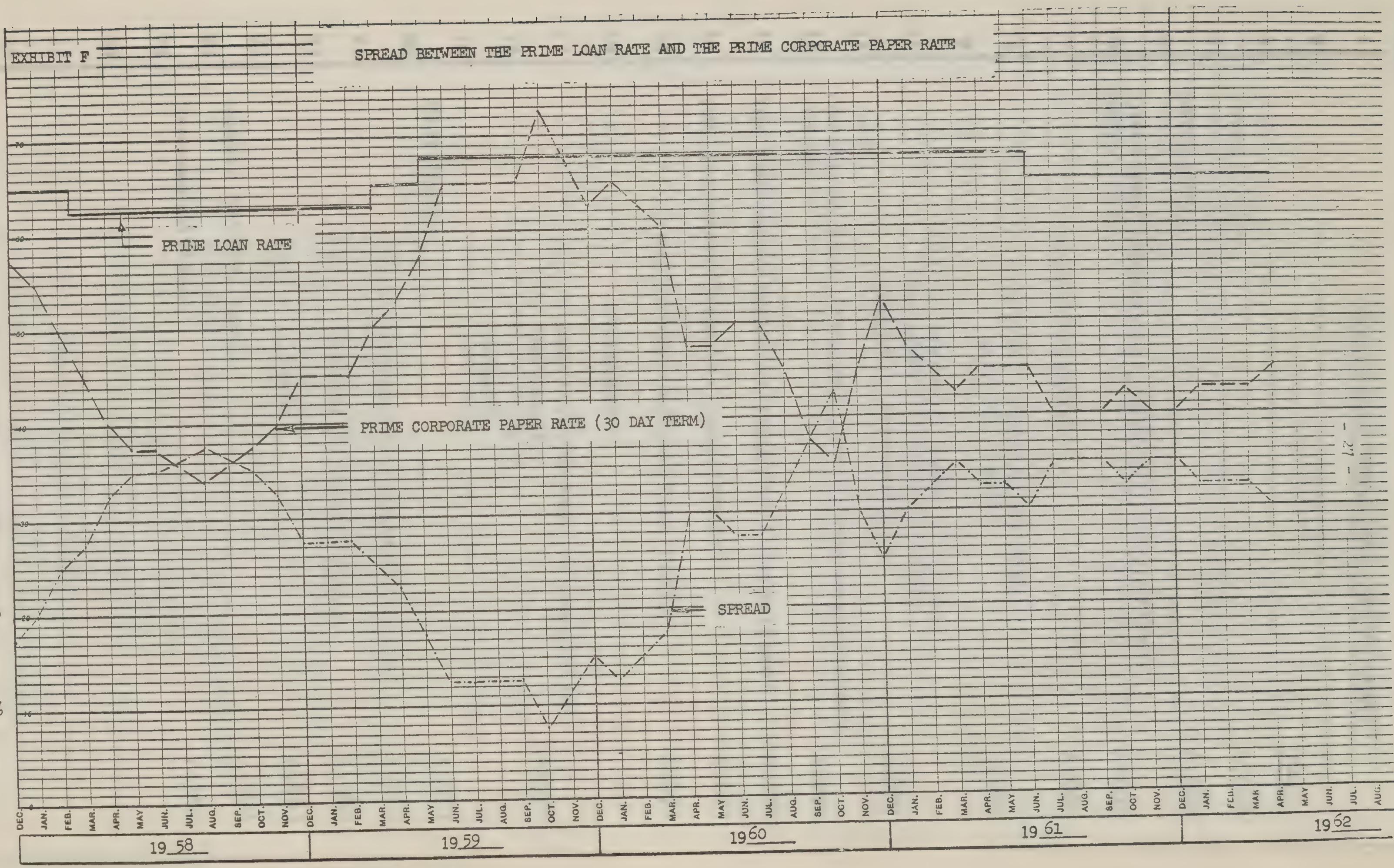
EXHIBIT F
SPREAD BETWEEN THE PRIME LOAN RATE AND THE PRIME CORPORATE PAPER RATE
PRIME LOAN RATE
PRIME CORPORATE PAPER RATE (30 DAY TERM)
SPREAD
6%
5%
4%
3%
2%
1%
0%
DEC. JAN. FEB. MAR. APR. MAY JUN. JUL. AUG. SEP. OCT. NOV.
1958
1959
1960
1961
1962

CHARTERED BANKS and "NEAR BANKS"

I N D E X

CHARTERED BANKS and "NEAR BANKS"

1. There is a close relationship between the business of the investment Dealer and the Canadian banking community. Accordingly, it is of prime importance that the Investment Dealer keep abreast of, and closely in tune with, changes that occur in banking policies and practices that may in any way affect the market for, and best possible distribution of, investment securities. It is appropriate that full advantage be taken of the investigations being made by this Commission to outline the existing relationships between the investment Dealer industry and the Chartered Banks and "Near-Banks", and to closely examine these relationships in a search for ways of improving the functioning of the whole capital market.

2. DEFINITIONS -- For the purposes of this presentation, we shall define --

(a) Chartered Banks -- as those Banks which come under the provisions of the Bank Act.

(b) Quebec Savings Banks -- as those Banks which come under the provisions of the Quebec Savings Bank Act.

(c) Near-Banks -- All other institutions which receive deposits (some times with chequing privileges) and/or make loans, e.g., Trust Companies, Mortgage and Loan Companies, Caisses Populaires, Credit Unions and, in some aspects of their operations, Finance Companies, Small

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Loan Companies, Provincial and Municipal Governments and Industrial and Commercial Corporations.

INVESTMENT DEALERS AS CUSTOMERS OF CHARTERED BANKS

(a) As borrowers

3. The nature of our business, involving periodic underwritings, and the carrying from day-to-day of large inventories of securities, requires large scale borrowing by way of, what are known as, call loans and day loans. These loans are secured by the deposit of securities pending sale or delivery. It is important that such loans be readily available at minimum cost.

4. The Chartered Banks at one time were virtually the only source of such funds. In recent years other sources have appeared and assumed growing significance.

5. Call loans and day loans to Investment Dealers carry a high credit rating involving a minimum risk. As evidence of their quality, the Bank of Canada includes these loans in their banking statistics under the heading "More Liquid Assets", along with Bank of Canada Notes and deposits, Treasury Bills, Government Bonds and net Foreign Assets. They are highly acceptable means of employing cash not immediately needed elsewhere.

6. The demand for these loans is constant in nature, although fluctuating some times widely, in amount. (See Exhibits A.1, A.2, A.3).

7. The revenue accruing to the Chartered Banks as well as to other lenders arising from interest charges on these loans is shown in Exhibit B.

Loan Companies, Provincial and Municipal Governments and Industrial and Commercial Corporations.

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8. A special scale of interest rates usually graduated upwards by several categories of collateral from the shortest term most liquid, to the longer term less liquid, is applied by the banks to such loans. These graduations are inferred to be related to market yield rates for such collateral, with appropriate changes made as circumstances warrant.

9. In practice, however, the dealers have found an element of rigidity built into these scales, particularly during periods of heavy demands for commercial loans (e.g., schedule unchanged from August 10, 1959 to October 11, 1960, remaining at flat 5 3/4 per cent rate for all categories, except two, of collateral, although bond yields, as shown below, fell sharply during that period, e.g.,

Canada 3 3/4%	Sept.1/65	Aug.26,1959	88 1/4	6.12%
		Sept.28,1960	98 1/2	4.07
4 1/2%	1983	Aug. 26,1959	87 3/8	5.45
		Sept.28,1960	94 11/16	4.89

During this same 14 months' period, the rediscount rate declined from 6.41 per cent on Aug. 13, 1959 to 1.95 per cent on September 29, 1960.

10. Also the date, when these high rates were applied, virtually coincided with the date when bank general loans, having increased by 24 per cent or $1,211 million between Oct. 1, 1958 and Aug. 19, 1959 levelled off and then declined between August 19th and Dec. 31st, by $213 million. This downward trend continued during the first quarter and then turned upward again somewhat more than seasonally for the

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remainder of 1960. Throughout this period call loan rates remained unchanged.

11. It is recognized that Sec. 91 of the Bank Act and Sec. 71 (1) of the Quebec Savings Bank Act, placing a ceiling of 6 per cent on the rate of interest banks may charge, inhibits the banks, in periods of excessive demand for loans, from using "price" as a restraint on general loan expansion, induces a type of loan rationing, and contributes to lack of flexibility when interest rates start to decline.

12. It must also be recognized, however, that this "price" factor, especially during the 14 months referred to above, did contribute directly to the development of a large and significant alternate source of short term funds for the Investment Dealer -- the so-called 'Country Banks", an expression particular to our industry but for the purpose of this Brief included in the definition of "Near-Banks". The dealers, in the face of apparent indifference on the part of the Chartered Banks, sought out other sources of accommodation with no little success.

13. If the dealer could be satisfied that the call loan interest rates of the banks were subject to periodic review and appropriate action to keep them in line with market conditions, and competitive with non-bank rates, many of the call loans being obtained in the Country Banking System, in all probability, would revert to the Chartered Banks. Costs being reasonably close, the dealer, generally speaking, would prefer to keep his banking within Chartered Banking circles.

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The Ceiling on Bank Interest Rates -- The Bank Act - Section 91.

14. "Except as provided in subsection (2), no bank shall in respect of any loan or advance payable in Canada stipulate for, charge, take, reserve or exact any rate of interest or any rate of discount exceeding six per cent per annum and no higher rate of interest or rate of discount is recoverable by the bank." A similar restriction appears in Sec. 71 (1) of the Quebec Savings Bank Act.

15. We believe that this provision, in periods of financial stringency, prevents the banks from using "price" as a deterrent to undesirable loan expansion. When loaning resources become strained, the Banks must resort to a form of rationing, with the attendant dangers of discrimination as between different classes of borrowers.

16. The Near-Banks, to whom the ceiling does not apply, can use higher interest earnings to pay higher rates on deposits and so gain an advantage over the Chartered Banks.

17. Our Association believes that this interest ceiling should be removed, as was recommended in the McMillan Report 1933. Chapter VII para. 253 -- "Four of us are of opinion that a statutory maximum rate of interest is nowadays anomalous and an undesirable interference with freedom of contract....by a majority, we recommend the repeal of the provision in question."

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Investment Dealers as Customers of Chartered Banks(cont'd)

(b) As users of bank facilities to effect deliveries and complete transactions.

18. The Chartered Banking System provides the dealer with invaluable service facilities contributing materially to the quick, convenient completion of transactions and deliveries of securities.

19. There is, however, an area within this field, involving daylight overdrafts, where unacceptably high bank charges have led the dealer to devise a rather cumbersome but effective means of reducing the impact of these costs.

20. It is suggested that a joint committee of the I.D.A. and the C.B.A. might be constituted to which these and other problems of mutual concern could be referred for frank discussion and possible solution.

THE BANKS AS AN IMPORTANT SECTOR IN THE MARKET FOR SECURITIES

21. As a custodian of the bulk of the personal savings deposits of millions of Canadians, the manner in which these assets are employed is of major significance to the economy as a whole and certainly to the security markets.

22. At the end of 1945, savings deposits stood at $2,865 million. At the same time, Government of Canada and Provincial securities owned by the banks amounted to $3,586 million, of which $1,415 million were under two years in term.

23. By the end of 1946, personal savings had grown to $3,476 million, with the holdings of Canada and Provincial bonds rising to $3,693 million, of which

[illegible]

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20. It is suggested that a joint committee of the I.D.A. and the C.B.A. might be constituted to which these and other problems of mutual concern could be referred for frank discussion and possible solution.

THE BANKS AS AN IMPORTANT SECTOR IN THE MARKET FOR SECURITIES

21. As a custodian of the bulk of the personal savings deposits of millions of Canadians, the manner in which these assets are employed is of major significance to the economy as a whole and certainly to the security market.

22. At the end of 1945 savings deposits stood at $2,865 million. At the same time, Government of Canada and Provincial securities owned by the banks amounted to $3,586 million, of which $1,415 million were under two years in term.

23. By the end of 1946, personal savings had grown to $3,476 million, with the holdings of Canada and Provincial bonds rising to $3,693 million, of which

$1,308 million were under two years in term.

24. This state of affairs led to an agreement effective March 1, 1946 on the part of the chartered banks with the Bank of Canada that their investments in Government of Canada, direct and guaranteed issues (other than Treasury Bills, Deposit Certificates and Treasury Notes), would not average more than 90 per cent of the amount of their Canadian personal savings deposits. The banks also agreed that their earnings on such bonds should not exceed the cost of operating their savings business by more than a moderate profit margin. (Bank of Canada Report 1946 - page 14....Since cancelled as no longer necessary or desirable.)

25. In the following year, there was a net decline of $170 million in Chartered Bank holdings of Government of Canada bonds, but their holdings of Provincial and Municipal securities increased by $159 million and their portfolio of other non-Government securities -- largely corporate debentures -- by $147 million. In that year, the Chartered Banks accounted for $316 million of a total of $327 million net increase in Canadian bonds and stocks outstanding.

26. The extent of the Chartered Banks' participation in the market for non-Government securities diminished in importance from this point onward, with other investors absorbing almost all the large net increase of non-Government securities. (See Statistical Table - Bank of Canada - Exhibit C).

27. Since 1948, the Chartered Banks have employed an increasing proportion of deposits in

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commercial loans. It is only when the demand for short-term loans lessens that the banking system becomes a purchaser of securities. As a corollary, an increase in the demand for loans leads to the selling of securities by the banking system. The investment function is residual to the loaning function.

28. The attached statistics (Exhibit D) show the security holdings by category of the chartered banks for the past sixteen years. As can be readily seen, the holdings of Government of Canada securities (including treasury bills) is by far the most volatile type of investment. In respect to holdings of Government of Canada securities beyond the two year area, it may be assumed that the vast majority mature within a five year period. In addition, maturity holdings beyond a ten year period are likely to be an exception. Generally, provincial holdings are well within the ten year maturity range. As to municipals, bank purchases fall within the 1 - 10 year range, the choice depending upon money position and interest in the municipality involved. The holdings of corporate securities are normally limited to under the ten year area, with, however, some exceptions being made for special bank clients. The acquisition of term corporation securities, wherein a chartered bank purchases all or a large portion of a private placement has, since 1955, been subject to restrictions arising out of an agreement amongst the Chartered Banks which has been varied from time to time in light of conditions. We concur in the desirability of these restrictions.

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CHARTERED BANK INVESTMENT PRACTICES AND MONETARY POLICY

29. The residual nature of Chartered Bank investment policy subjects the market place to rather violent swings in security prices and yields. The effect is particularly evident in short-term Government of Canada securities. An example of this effect, and the resultant effects on the whole interest rate structure, was evident in 1959 when the banking system, with demand for short term loans inordinately high, was a substantial seller of short term securities, thereby driving the yield of two year Canada through 6 per cent. During the following two years, the banking system was a net purchaser of short term securities and the yield on two year Canadas declined to as low as 3½ per cent.

30. Referring to pages 27 - 31 of the Bank of Canada Report of 1956 (Exhibit E) the Governor describes a serious weakness in the monetary control mechanism. The events of 1959 demonstrate the ineffectual use of monetary controls when the banking system has the liquidity to thwart the desired results of the control measures. The attached statistics (Exhibit D) indicate that during the past eleven years, the Chartered Banks have placed an increasing percentage of their assets in Government of Canada securities maturing under two years. During the same period, a decreasing percentage of those assets have been invested in all securities maturing over two years. When considered in relation to personal savings deposits, the decline in the ratio of security holdings maturing over two years to personal savings deposits is evident. (Exhibit F).

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31. It is clear that the liquidity position of the banking system has been enhanced considerably during this period to the point where the desires of the monetary authorities might be effectively thwarted.

32. If it is considered desirable to attempt to reduce the long term interest rate on Canadian securities in order to moderate the flow of long term foreign investment, and, at the same time, establish the foreign exchange values of the Canadian dollar commensurate with the balance of trade position of the nation, the savings of the Canadian people would have to be mobilized to a maximum degree, and a proper proportion shepherded into the kind of investment naturally associated with long term savings. This suggests as an avenue of exploration the possibility that personal savings deposits held by the Chartered Banks, which have shown a steady upward trend (Exhibit F), might be made available to a greater extent than at present is the case for long term investment.

33. This whole question is discussed at considerable length in the Bank of Canada Annual Report 1956. (Exhibit E). The suggestions developed therein might well be examined in the light of present day conditions. In the words of that report: "The possibility of a gradual approach towards arrangements of the sort outlined would seem to be worthy of study and discussion. Progress in such an approach would be directed towards expanding mortgage loans and other appropriate investments based on future increases in savings deposits, not reducing the volume of commercial

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or general loans."

THE CHARTERED BANKS AS ISSUERS OF SECURITIES

34. Though the chartered banks have offered term deposit receipts to their clients for a good number of years, it has been only during the past two years that the instrument has been an effective competitive vehicle in the market place. In severe competition for the funds of the large depositor ($100,000 plus) with the "near-banks", the chartered banks offer term deposit receipts at various rates for terms up to one year. The volume of such deposits is unknown but considered to be substantial. A number of chartered banks also offer term deposit receipts for terms of one to five years at competitive rates. On this type of paper, the chartered bank may pay a commission to the investment dealer which secures the funds on its behalf. Again, volume figures are not published. Another vehicle of investment that the banking system offers from time to time to the potentially larger short-term depositor is what is usually called a U.S. Dollar Term Deposit. The chartered bank accepts the deposit at a given rate for a specific term, swaps the funds into U.S. dollars, with the profit or loss on the swap payable to the depositor, and invests the U.S. funds in the New York call loan market. This instrument has, at times, proven to be highly competitive vehicle, wherein rates obtainable can be appreciably better than what is available in the domestic market for similar quality.

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agreement between banks. On a number of occasions in the past two years, it has been demonstrated that the rate changes have not responded quickly to market conditions. It is probable that this lack of responsiveness is being, and will be, corrected in the future. In the case of term deposits maturing over one year, rates are determined independently, governed by returns obtainable in the employment of these deposits.

THE BANKS AND NEAR-BANKS AS COMPETITORS

36. The Investment Dealer must regard as a competitor any person or agency that performs, or offers to perform, any of what the dealer regards as his functions. Outlined below are some of the ways, and extent to which, the Banks and Near-Banks appear to invade our field.

(a) In the Underwriting Field

Canada and Canada Guaranteed Issues

37. Just as the dealers are offered varying percentages of each issue on a "firm" basis, so are the chartered banks, usually at the same concession from the sale price to the public. Since these are drawn down for resale, they are underwritings. Bonds purchased for the banks' own portfolio requirements, at the time of issue, are of course taken at the full issue price.

Provincial and Provincial Guaranteed Issues

38. One or more chartered banks are included in each syndicate formed to bid for, or negotiate the purchase of, provincial or provincial guaranteed bonds. They take an active part in the discussions, and are influential in the decisions reached, regarding terms.

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Municipals and Municipal Guaranteed Issues

39. As with provincial issues, one or more chartered banks are frequently included in the syndicate's bidding for, or negotiating the purchase of, municipal debenture issues, particularly in the case of large municipalities. Where serial issues are involved, and these are in the majority, the banking member or members of the syndicate not infrequently agree to purchase for their own account the early maturities. So the degee of enthusiasm shown by the banking members has a direct bearing on the price finally agreed upon.

40. Again, the banking members share, accordingto their interest, in any dyndicate profits that emerge -- and again their interest in the syndicate does not necessarily bear a relationship to their contribution as a distributor.

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41. The involvement of banks in underwriting of corporate issues is much less usual than in the case of government financing. The Bank Act (Para. 157(2)) forbids the use of the name of any chartered bank "in a prospectus of advertisement for the sale of securities of any kind other than those issued by, or guaranteed

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42. This Section of the Bank Act, and the agreement referred to, which agreement we understand has been renewed and somewhat expanded from time to time, clearly implies intended definite limitations as to the extent to which the chartered banks should venture into the field of distribution of securities other than those issued by governments, and into the corporate underwriting field.

43. Nonetheless, there are important instances where chartered banks are members of, and actively participate in the management of, syndicates formed for the purpose of underwriting securities of large corporations.

Comments on Banks as Members of Underwriting Syndicates

44. The question as to whether the public interest or any useful purpose is served through the inclusion of chartered banks in underwriting syndicates is one upon which there is considerable disagreement amongst our members. It is recognized that many of these arrangements were entered into many years ago, probably when there were good reasons for them. The Brief

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45. The investment banking industry of those days was in the early stages of its development. It possessed only a small measure of the experience and financial strength that it has since acquired. Over the intervening years, the industry has matured and has demonstrated its ability to cope with the challenges with which it has been faced in meeting the capital needs of the Government of Canada, of other governments and public bodies, and of credit-worthy corporations. No longer is it necessary to hold out the golden carrot of a share of syndicate profits to obtain the banking accommodation it requires to fulfil its commitments. The fact remains that one or more chartered banks are members of most municipal syndicates of any size, of all

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46. Those of our members who take no exception to these arrangements maintain that the presence of banks in municipal syndicates adds strength to the bids where their banking partner agrees to absorb the early maturities. In provincial syndicates where the issues are set up on a fiscal agency basis, they acknowledge that the presence in the syndicates of the Province's bankers is helpful in negotiations. When negotiations are completed and liabilities taken, the assumption by the banking syndicate members of their share of the risks involved is reassuring to many of the syndicate members. During the process of distribution, the manner in which the banks deal with their participations may aid orderly distribution and lend stability to the after market.

47. In those relatively few cases of membership in corporate syndicates where the relationships are of relatively long standing, many of our members would not press to have these relationships disturbed. The majority of our members, however, would strongly discourage any extension of the practice.

48. Those of our members who object to the presence of chartered banks in underwriting syndicates support their position with these arguments:

(a) There are many possibilities of undesirable conflicts of interest arising out of intermingled customer relationships, particularly where the bank assumes the

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(b) The primary function of the chartered banks is to provide for the short-term capital needs of its customers, whether public or private. The primary function of the Investment Dealer is to find long-term capital for both governments and corporations.

(c) It is in the public interest and important to the Chartered Banks themselves that the investment banking industry maintain a healthy growth consonant with the growth of the country's economy. The curtailment of the dealer's field of activity through undue invasion and penetration by the Chartered Banks is bound to inhibit the growth and development of the investment dealer industry and so its ability to adequately perform its proper function within the economy.

49. The common ground within the conflicting points of view of our members is that there be no extension of the practice of including chartered banks within underwriting syndicates nor delegation to them of the management function.

The Banks and Near-Banks as Competitors

(b) In Distribution of Securities to the Public

50. The Chartered Banks, and to a lesser but significant extent the Near-Banks, actively engage in the

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(b) <u>In Distribution of Securities to the Public</u>

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sale of securities to the public as agents and, not infrequently, as principals. They enjoy peculiar advantages over the dealers through their widespread branch systems, with only incidental distribution costs, and possessing knowledge of their customers' resources.

(1) As officially named and recognized agents and receiving the same selling commissions as the Dealers, the Chartered Banks and the Trust Companies participate in the distribution of Canada Savings Bond issues and in the newly emerged type of provincial parity bonds. It is worth noting that this type of distribution does not involve positions or risk, nor the exercise of investment judgment. In addition to selling commissions, the banks receive remuneration as issuing agents, thereby profiting from the successful efforts of the Dealers.

(2) As members of Selling Groups -- In those new issues where Selling Groups are formed, the usual procedure is to include all members of the I.D.A. and the Chartered Banks. This entitles the Banks to acquire the securities involved on the same basis as do the Dealers.

(3) As principals -- in issues where the Banks are members of underwriting syndicates. Here it is assumed that the Banks utilize their securities departments in the distribution of their participation. The Banks also, in a substantial way, act as

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principals in their secondary market operations.

Comments on Banks as distribution of securities to the public

51. It is recognized that the Canadian Chartered Banks with their comprehensive branch system, and intermingling in their operations as they do commercial and savings bank functions -- functions which elsewhere are usually separated -- have an advantage over the Dealer in reaching the potential investor at low and only incidental cost. Their effectiveness in Canada Savings Bond and similar campaigns is acknowledged, as is also their usefulness in serving the investment requirements of the customers of branches in small communities beyond the reach of investment houses. The Dealers, to offset these advantages, rely upon their specialized training and knowledge and concentration upon their particular functions.

52. In view of the reliance placed by the Chartered Banks on savings deposits as a funds source from which to expand commercial loans, there arises the question of conflict of interest, the conceivable tendency on the part of individual branch managers to discourage investment in order to maintain savings deposits. This could happen at the very time non-bank buyers are needed to absorb the pressure on the bond market of sales of securities by the banks to meet heavy demand for loans. At such times the burden of finding buyers falls on the investment dealer sales force and it is important that such sales force be available, in

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sufficient size, vigorous and resourceful enough, to do an effective job.

"NEAR-BANKS"

53. In our definitions, "near-banks" were described as institutions which perform one or more banking function, i.e. -- receive deposits and/or loan funds. As examples, we mentioned trust companies, caisses populaires, credit unions, finance companies, small loan companies, mortgage companies, corporations and provincial and municipal governments. Though it can be said that every financial intermediary performs one or more banking functions, the growth and the competitiveness evidenced in the above-mentioned institutions have made them subject to an increasing amount of comment in recent years.

54. We wish to discuss the relationship of these financial institutions to the investment dealer and to comment upon the impact on the financial framework of the nation consequent upon the growth in their resources.

RELATIONSHIP OF "NEAR-BANKS" TO INVESTMENT DEALER

(a) As Sources of Borrowed Capital

55. As a result of the inadequacy and cost of chartered bank accommodation during various periods in the last ten years, the trust company, the provincial and municipal government and the corporate entity have become important suppliers of demand andterm funds to the investment industry. The volume of such loans is indicated in the weekly figures that have been collected by this Association since November of 1960. Were it not

sufficient size, vigorous and resourceful enough, to do an effective job.

"NEAR-BANKS"

53. In our definitions, "near-banks" were described as institutions which perform one or more banking function, i.e. -- receive deposits and/or loan funds. As examples, we mentioned trust companies, caisses populaires, credit unions, finance companies, small loan companies, mortgage companies, corporations and provincial and municipal governments. Though it can be said that every financial intermediary performs one or more banking functions, the growth and the competitiveness evidenced in the above-mentioned institutions have made them subject to an increasing amount of comment in recent years.

54. We wish to discuss the relationship of these financial institutions to the investment dealer and to comment upon the impact on the financial framework of the nation consequent upon the growth in their resources.

RELATIONSHIP OF "NEAR-BANKS" TO INVESTMENT DEALER

(a) As Sources of Borrowed Capital

55. As a result of the inadequacy and cost of chartered bank accommodation during various periods in the last ten years, the trust company, the provincial and municipal government and the corporate entity have become important suppliers of demand andterm funds to the investment industry. The volume of such loans is indicated in the weekly figures that have been collected by this Association since November of 1960. Were it not

for the availability of these funds there is little doubt the investment dealer costs would have been greater during the past three years.

56. As well as providing funds to investment dealers, the "near-bank" also provides short term funds to other financial intermediaries, e.g. -- corporate borrowers, finance companies and provincial and municipal governments. Although the volume of such loans outstanding at any one time is intermediate, there is reason to believe that it would be very considerable.

(b) As Issuers of Securities

57. The "near-bank" offers a considerable variety of securities ranging from demand deposits to debentures, to deposit receipts, to certificates of deposits, to short term promissory notes and to secured or unsecured finance paper. Terms can vary from one day to five years and in size from $1,000 to millions of dollars. The securities are offered directly to the general public by some of these institutions, while others deal only through investment dealers, who act as principals or agents in the placement of these securities. Most of the "near-banks" attempt to secure their funds by both avenues. The investment dealer, when acting as an agent, obtains a commission for his service. When performing as a principal, the dealer re-offers the security at a price that will provide a profit.

58. There has been concern expressed in recent years as to the responsibility of the dealer in the placement of the securities of "near-banks". The pressure exerted within a firm to secure funds for a

for the availability of these funds there is little doubt the investment dealer costs would have been greater during the past three years.

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58. There has been concern expressed in recent years as to the responsibility of the dealer in the placement of the securities of "near-banks". The pressure exerted within a firm to secure funds for a

client have, undoubtedly, resulted in the placement of securities of dubious quality. We believe that the investment dealer must bear responsibility for the quality when the investing client is not in a position to judge the credit risk. The sophisticated investor requires no such protection. It is the belief of this Association that any rules and regulations in this respect could be easily circumvented.

(c) <u>The "Near-Banks" as Clients</u>

59. The growth in assets of some of the institutions included in the category "near-banks" is graphically represented in the attached exhibits. We have shown the substantial increase in bonds, mortgage and stock holdings of the trust and loan corporations and in the investments (No published breakdown of these investments is available covering all credit unions but the Province of Quebec report on Caisses Populaires for 1960 indicates that over 75 per cent of the total investments of all credit unions were held by the "Caisses" of that Province, distributed as follows:

Canadian Government Bonds	$ 24,092,466
Provincial Government Bonds	34,905,525
Municipal or School Corporation Bonds	105,800,943
Church Fabric Bonds, Ecclesiastic and Religious Corporation Bonds	47,226,664
Total	$212,025,598)

of credit unions during the past ten years. The attached statistics for Canadian trust companies also demonstrate the substantial growth that has taken place in the past ten years in assets under administration,

client base, [illegible] themselves as the [illegible]

securities of dubious quality. We believe that the investment dealer must bear responsibility for the quality when the investing client is not in a position to judge the credit risk. The sophisticated investor requires no such protection. It is the belief of this Association that any rules and regulations in this respect could be easily circumvented.

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Canadian Government Bonds	$ 24,092,460
Provincial Government Bonds	34,995,525
Municipal or School Corporation Bonds	105,800,943
Church Fabric Bonds, Ecclesiastic and Religious Corporation Bonds	[illegible]
Total	[illegible]

of credit unions during the past ten years. The attached statistics for Canadian trust companies also demonstrate the substantial growth that has taken place in the past ten years in assets under administration.

i.e. -- estates, trusts and agency funds. When it is considered that these statistics cover the assets of only certain of the "near-banks", it is evident that these institutions have a significant impact on the market-place.

QUEBEC SAVINGS BANKS

The attached statistics (Exhibit 1) show the extent to which the assets of the Quebec Savings Banks are invested in Canadian securities.

RECOMMENDATIONS

It is recommended to the Commission that consideration be given to the following suggestions:

Pr. 3 Page A.463 to Pr. 13 Page A.465

(1) that the chartered banks adopt policies and procedures designed to satisfy the investment dealers that their call loan interest rate schedules are to be subject to periodic review and appropriate action to keep them in line with market conditions and competitive with the rates under which similar loans may be obtained from non-bank sources.

Pr. 14 Page A.466 to Pr. 17 Page A.466

(2) that Section 91 of the Bank Act and Section 71 (1) of the Quebec Savings Bank Act, imposing a ceiling of 6 per cent on the rate which may be charged upon bank loans, be repealed as being "an undesirable interference with freedom of contract."

(3) that every encouragement should be given to the continued healthy development of the Investment Dealer's ability to perform

i.e. -- estates, trusts and agency funds. When it is considered that these statistics cover the assets of only certain of the "near-banks", it is evident that these institutions have a significant impact on the market-place.

[illegible]

The attached statistics (Exhibit 1) show the extent to which the assets of the Quebec Savings Banks are invested in Canadian securities.

[illegible]

It is recommended to the Commission that consideration be given to the following suggestions:

(1) that the chartered banks adopt policies and procedures designed to satisfy the invest-

Pr. [illegible] ment dealers [illegible]

Page A.463 rate schedules are to be subject to periodic

to Pr. 13 review and appropriate action to keep them

Page A.465 in line with market conditions and competitive with the rates under which similar loans may be obtained from non-bank sources.

(2) that Section 91 of the Bank Act and

Pr. 14 Section 71 (1) of the Quebec Savings Bank Act,

Page A.466 imposing a ceiling of 6 per cent on the rate

to Pr. 17 which may be charged upon bank loans, be

Page A.466 repealed as being "an undesirable interference with freedom of contract."

(3) that every encouragement should be given to the continued healthy development of the Investment Dealer's ability to perform

satisfactorily the important underwriting function and in particular:

(a) that the banks continue to refrain from making term loans (in excess of a reasonable limit in amount) to business corporations where the time of repayment is deferred beyond that of ordinary bank loans, or purchasing a security negotiated directly with the customer as distinct from buying a publicly issued security in the market.

Pr. 28 Page A.469 and Pr. 41 Page A.474 to Pr. 42 page A.475

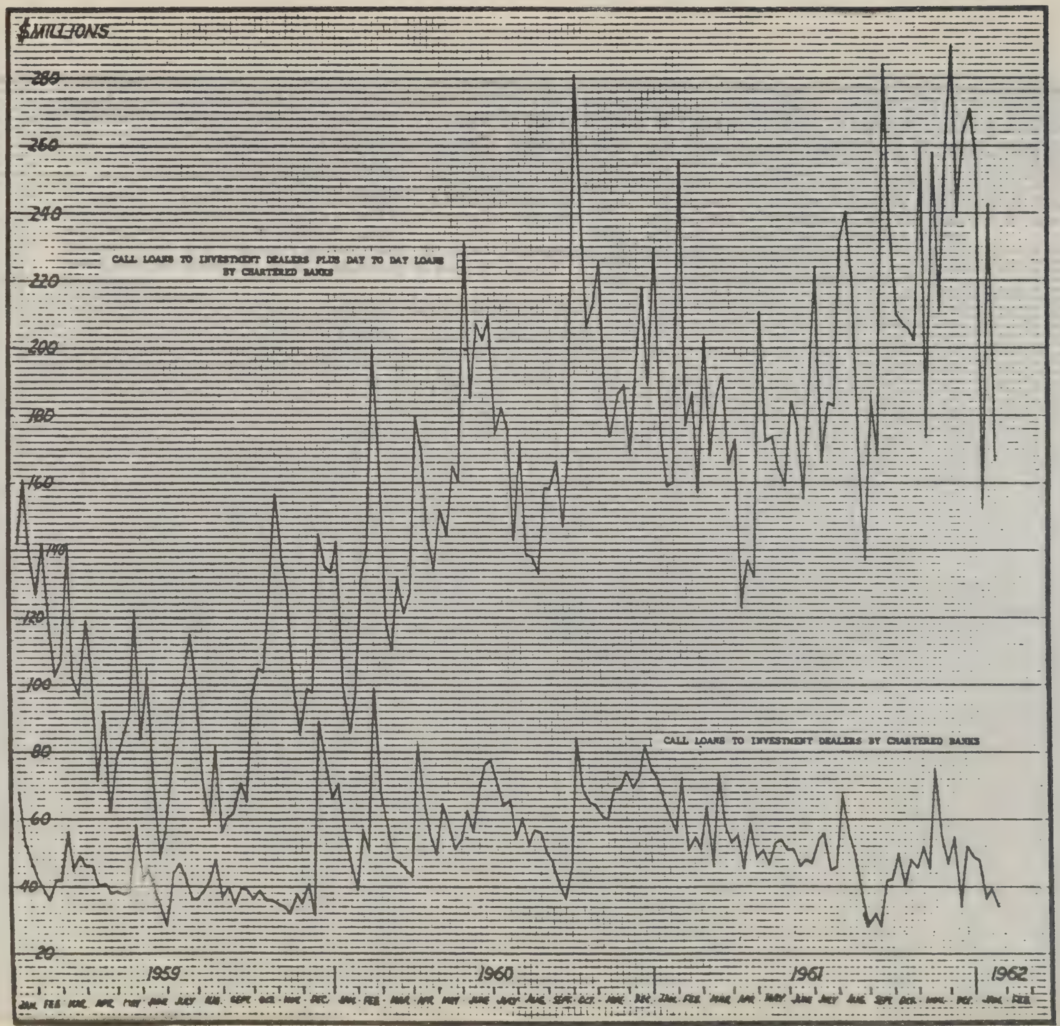
(b) that there should be no further extension, beyond the relatively few cases of long standing which may exist, of the inclusion of banks in syndicates underwriting corporate securities for resale to the public, particularly where such inclusion would place the bank in the dual position of banker and underwriter and where the sale of corporate securities is for the purpose of paying off bank loans.

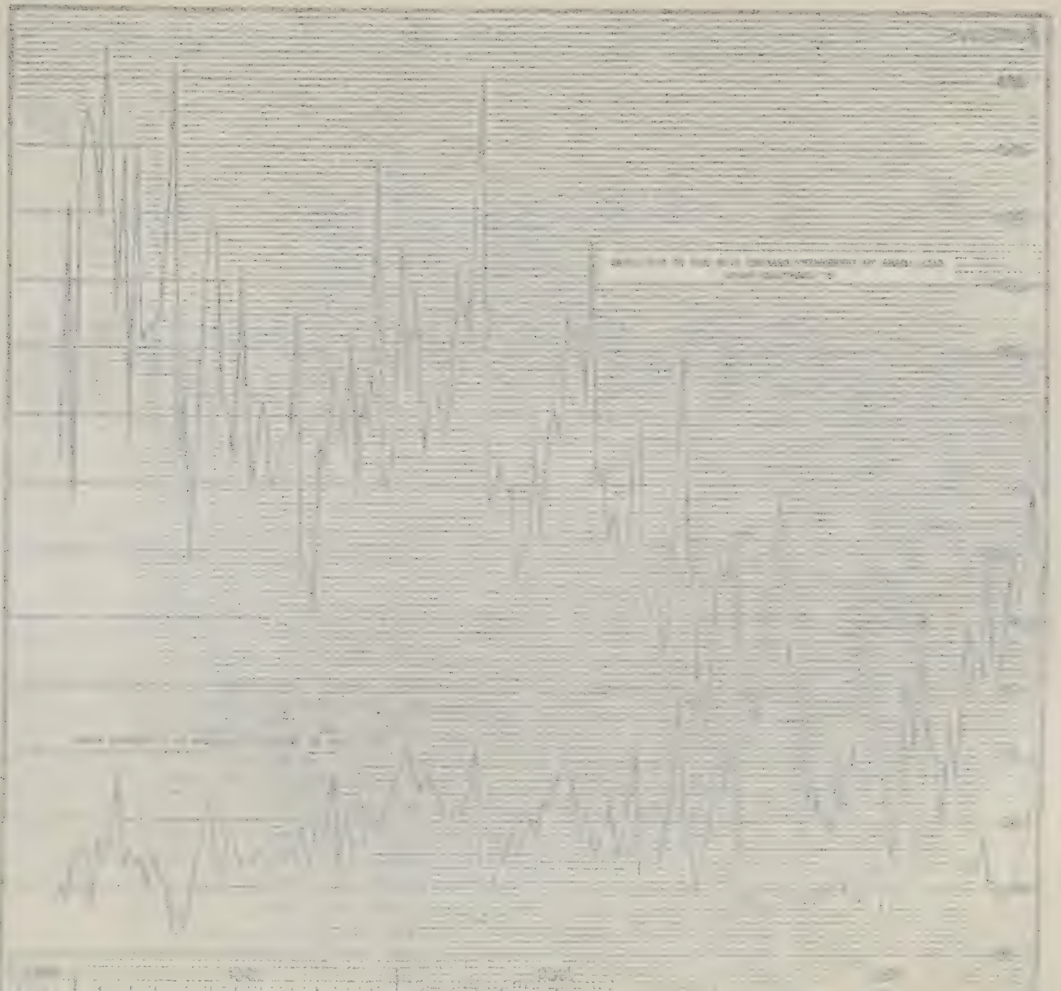
Pr. 44 Page A.475 to Pr. 49 Page A. 478

EXHIBITS

A.	Graph 1	Investment Dealer Call Loans and Day Loans placed with Chartered Banks
	Graph 2	Investment Dealer Call Loans and Day Loans placed with "Country Banks".
	Graph 3	Investment Dealer Call Loans and Day Loans -- Total
B.		Revenue accruing to Chartered Banks and other lenders from Call and Day Loans
C.	Table	Changes Security Portfolios of Chartered Banks related to Net Issue or Retirement of Canadian Bonds and Stocks (Bank of Canada Report 1949 - page 7)
D.		Selected Chartered Bank Statistics
	Table 1	Earnings and Balance Sheet Items 1952-1961
	Table 2 (a)	Distribution of Investment Holdings 1946-1953
	Table 2 (b)	Distribution of Investment Holdings 1954-1961
E.		Bank of Canada Report 1956 (pages 27-31)
F.	Graph	Canadian Chartered Bank Investment Holdings related to Personal Savings Deposits and Loans
G.	Graph I	Trust Companies Loan Corporations
		Statistics re above
	Tables 1-4	Trust Companies
	Tables 5-6	Loan Corporations
H.		Credit Unions
	Table	Balance Sheet Items 1951-1960
I.		Quebec Savings Banks
	Table -	Balance Sheet Items 1951-1960

EXHIBIT A
Graph 1





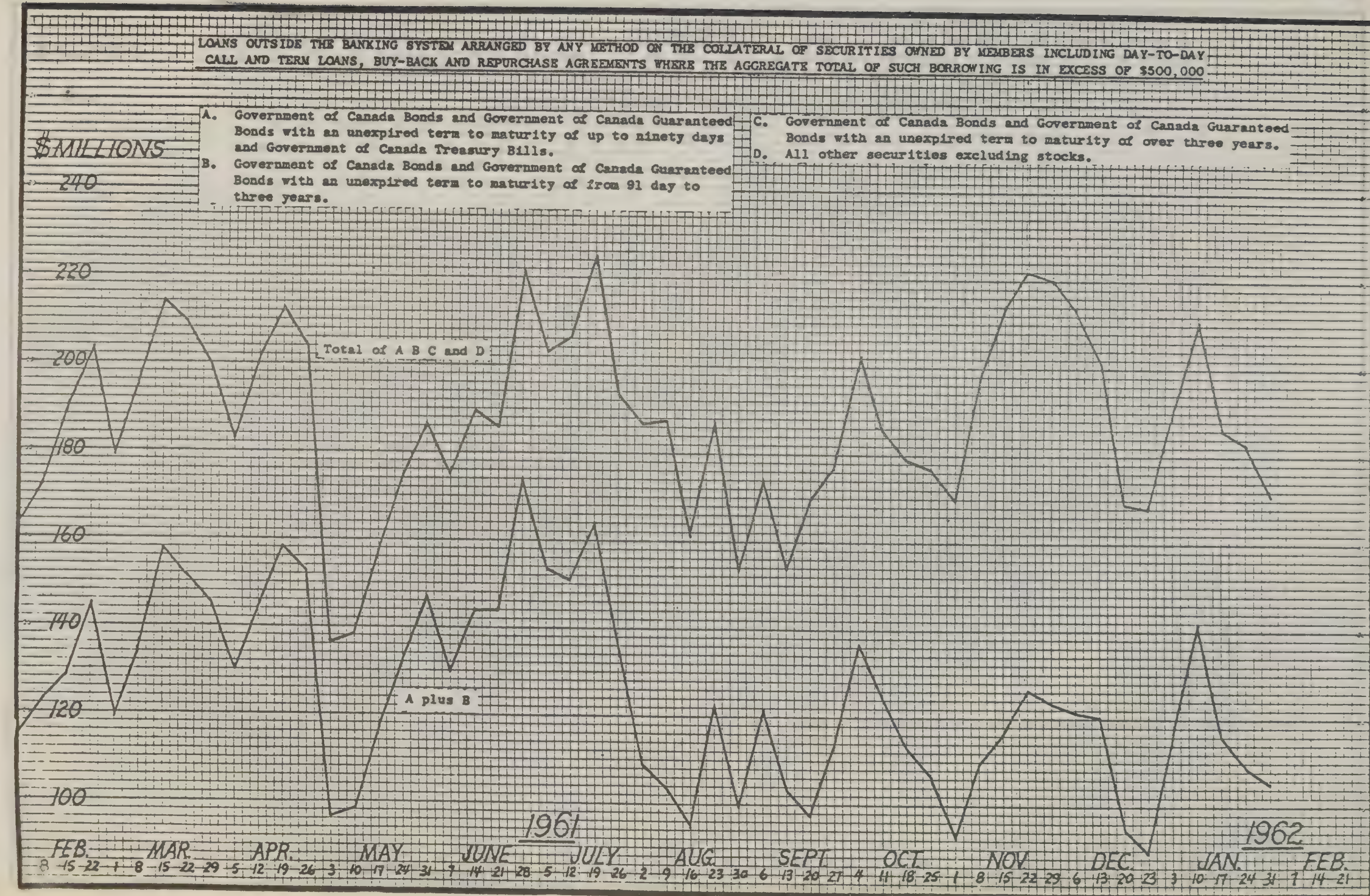

LOANS OUTSIDE THE BANKING SYSTEM ARRANGED BY ANY METHOD ON THE COLLATERAL OF SECURITIES OWNED BY MEMBERS INCLUDING DAY-TO-DAY CALL AND TERM LOANS, BUY-BACK AND REPURCHASE AGREEMENTS WHERE THE AGGREGATE TOTAL OF SUCH BORROWING IS IN EXCESS OF $500,000
A. Government of Canada Bonds and Government of Canada Guaranteed Bonds with an unexpired term to maturity of up to ninety days and Government of Canada Treasury Bills.
B. Government of Canada Bonds and Government of Canada Guaranteed Bonds with an unexpired term to maturity of from 91 day to three years.
C. Government of Canada Bonds and Government of Canada Guaranteed Bonds with an unexpired term to maturity of over three years.
D. All other securities excluding stocks.
$MILLIONS
240
220
200
180
160
140
120
100
Total of A B C and D
A plus B
1961
1962
FEB. MAR. APR. MAY JUNE JULY AUG. SEPT. OCT. NOV. DEC. JAN. FEB.
8 15 22 1 8 15 22 29 5 12 19 26 3 10 17 24 31 7 14 21 28 5 12 19 26 2 9 16 23 30 6 13 20 27 4 11 18 25 1 8 15 22 29 6 13 20 23 3 10 17 24 31 7 14 21

EXHIBIT A
Graph 3

A.489
-H-

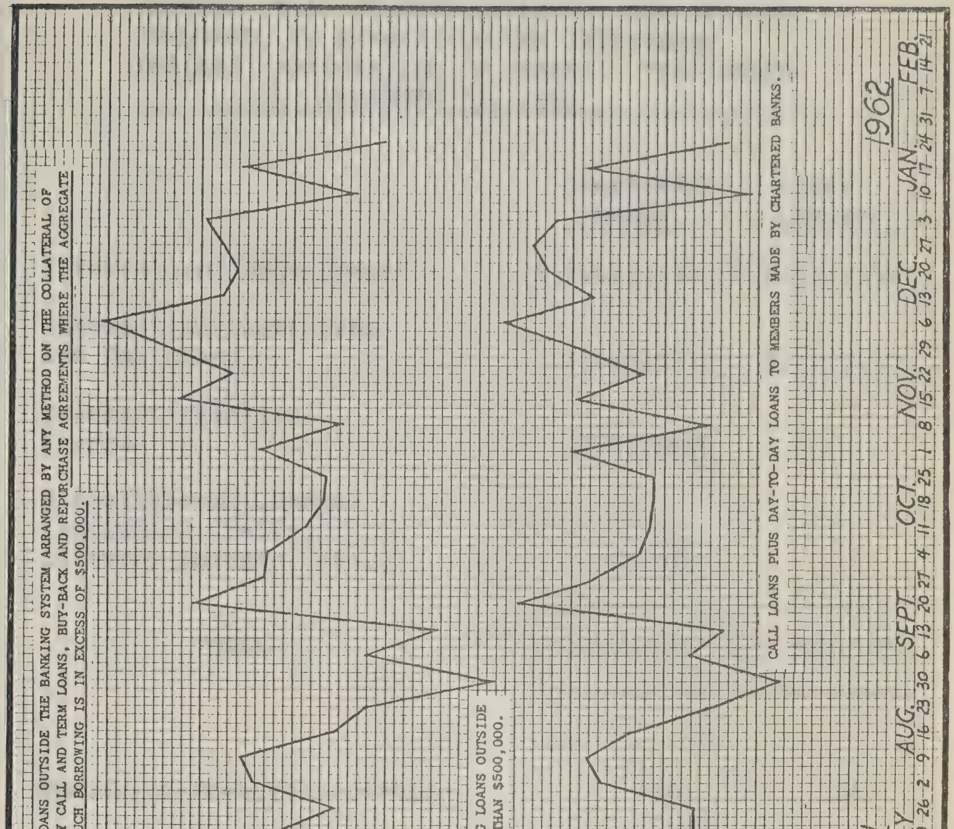


EXHIBIT B.

REVENUE ACCRUING TO CHARTERED BANKS AND OTHER LENDERS FROM INTEREST ON LOANS, AND SERVICES PROVIDED, TO MEMBERS OF THE INVESTMENT DEALERS' ASSOCIATION OF CANADA - YEAR ENDED DECEMBER 31, 1961

	Chartered Banks	Other Lenders
Interest on "Call Loans"	$ 4,522,548	$ 2,313,335
Interest on Short Term and Day Loans	3,656,621	3,225,230
Overcertification Charges	581,500	
Miscellaneous Charges (including drafts, delivery charges, etc.)	705,970	
TOTAL	$ 9,466,639	$ 5,538,565
Number of Members Reporting	186	186
Number of Members Reporting Nil	9	106
Number of Members Involved	177	80

EXHIBIT C

Type of Security	Net Issue or Retirement of Canadian Bonds and Stocks(3)					Net Increase or Decrease in Security Portfolios of Chartered Banks				
	1945	1946	1947	1948	1949	1945	1946	1947	1948	1949
Provincial	28*	18*	65	199	339	22	2	151	8	30x
Municipal	43*	5*	31	71	89	15	24	18	7	21
Corporation	25	68	231	260	211	23	88	147	98	68x
Total	46*	45	327	530	639	60	114	316	113	77x

* Retirement
x Decrease

(3) Source: Appendix A, page 29. The table understates the total volume of net new issues of these securities in the Canadian market by the amount of the net reduction of foreign holdings of such securities through reitrement or refunding.

Above from Bank of Canada Report 1949.

EXHIBIT C

Type of Security	Net Issue or Retirement of Canadian Bonds and Stocks(3)					Net Increase or Decrease in Security Portfolios of Chartered Banks				
	1945	1946	1947	1948	1949	1945	1946	1947	1948	1949
Provincial	22*	16*	65	199	339	22	2	151	5	34
Municipal	43*	5*	31	71	89	15	24	18	7	21
Corporation	25	68	231	260	211	23	88	147	98	68x
Total	46*	45	327	530	639	60	114	316	113	77x

* Retirement

x Decrease

(3) Source: Appendix A, page 29. The table understates the total volume of net new issues of these securities in the Canadian market by the amount of the net reduction of foreign holdings of such securities through retirement or refunding.

Above from Bank of Canada Report 1949.

Earnings ($ millions) (1) (2)	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952
Loans	540.5	525.5	455.1	386.9	380.6	314.2	236.3	219.3	191.6	166.3
Securities	196.6	182.3	169.4	160.5	118.4	102.8	128.4	124.3	111.4	100.8
Other	143.1	134.6	122.3	126.0	109.5	96.5	89.0	81.9	75.5	70.0
Operating Earnings	880.2	842.4	746.8	673.4	608.5	513.5	453.7	425.3	378.5	337.1
Operating Profit	209.5	214.9	178.4	167.8	137.0	125.1	111.7	113.3	109.8	84.3
Other Income	1.5	3.7	3.3	1.5	.4	3.1	(.6)	1.8	(.4)	—
Net Earnings	211.0	218.6	181.7	169.3	137.4	128.2	111.1	115.1	109.4	84.3
Depreciation	19.6	18.4	16.4	14.3	12.7	11.4	10.1	9.0	7.1	7.0
Losses & Add. Inner Res. Net	(10.6)	25.2	32.3	16.0	2.8	14.1	22.5	(32.9)	24.9	27.3
Taxes	101.7	90.7	65.2	69.6	56.6	41.7	37.2	58.0	30.1	25.5
Net Profit	100.3	84.3	67.8	69.4	65.3	61.0	41.3	81.0	47.3	24.5
Cash Flow	109.3	127.9	116.5	99.7	80.8	86.5	73.9	57.1	79.3	58.8
Dividends	67.8	54.0	47.6	40.0	35.4	31.9	26.2	21.5	20.4	18.6
Additions to Shareholders' Equity										
Capital:										
- New Issues	9.4	11.5	31.7	10.5	16.5	14.2	13.7	16.3	2.3	0.4
Rest Account:										
- Undivided Profits	14.5	16.8	9.0	14.2	8.0	15.9	8.7	9.0	16.1	10.5
- Retransfers from Inner Res.	27.1	15.7	8.5	16.8	18.7	19.0	4.0	48.0	17.0	
- Premium on Shares	14.6	36.2	72.9	28.6	33.3	42.1	19.8	29.9	1.9	0.5
Undivided Profits:										
- Undivided Profits (from oper. earn. net after transfers to rest acct.)	1.0	(2.2)	2.7	(1.5)	3.2	(5.7)	2.4	2.5	(6.1)	(4.6)
Net Additions	66.6	78.0	124.7	68.6	79.7	85.5	48.6	105.7	31.2	6.7
Balance Sheet ($ millions) (3)										
Assets:										
Cash Resources										
- Canadian	1,919.5	1,892.6	1,829.9	1,996.8	1,756.6	1,731.4	1,683.1	1,453.6	1,624.2	1,467.8
- Foreign	1,050.4	704.7	451.0	494.8	435.8	401.0	335.7	319.9	320.0	324.8
- Total	2,969.9	2,597.3	2,280.9	2,491.6	2,192.4	2,132.4	2,018.8	1,773.5	1,944.2	1,792.7
Securities										
- Canadian	4,781.4	4,142.6	3,882.8	5,025.4	3,523.1	3,583.1	4,493.9	4,132.2	3,561.0	3,914.4
- Foreign	835.9	723.6	527.8	589.6	431.8	371.1	299.7	310.0	227.9	232.7
- Total	5,617.3	4,866.2	4,410.6	5,615.0	3,954.9	3,954.2	4,793.6	4,442.3	3,788.9	4,147.1
Call Loans, etc.										
- Canadian	338.5	289.7	236.8	247.5	246.8	227.9	232.6	293.3	143.8	130.1
- Foreign	882.4	958.8	788.8	646.8	561.2	340.7	213.3	219.0	207.8	144.7
- Total	1,220.9	1,248.5	1,025.6	894.3	808.0	568.6	445.9	512.3	351.6	274.8
Total Liquid Assets	9,808.1	8,712.0	7,717.1	9,000.0	6,955.3	6.655.2	7,258.3	6,728.1	6,084.7	6,214.6
Loans Ex Call Loans										
- Canadian	6,483.3	6,127.8	6,109.0	5,034.5	5,232.7	5,223.3	4,442.9	3,894.0	3,839.9	3,213.8
- Foreign	918.0	827.3	762.4	620.6	454.5	360.0	332.6	281.7	258.7	262.8
- Total	7,401.3	6,955.1	6,871.4	5,655.1	5,687.2	5,583.3	4,775.5	4,175.7	4,098.6	3,476.6
Mortgages	955.0	977.7	944.7	743.1	551.7	471.3	235.5	38.3	.4	.4
Miscellaneous	648.6	580.4	480.2	471.0	451.4	394.2	360.0	303.2	322.7	350.1
	18,813.0	17,255.2	16.013.4	15,870.2	13,645.6	13,104.0	12,629.3	11,245.3	10,506.4	10,041.7
Extract:										
Primary and Secondary Reserves										
- Notes of and Deposits in the Bank of Canada	1,120.9	1,005.0	960.4	952.3	895.6	884.3	858.3	815.5	N.A.	N.A.
- Call Loans, etc. (4)	338.5	289.7	236.8	247.5	246.8	227.9	232.6	293.3	N.A.	N.A.
- Gov't. of Can. Treas. Bills	1,269.8	1,015.5	912.2	985.6	830.3	791.1	337.4	371.5	N.A.	N.A.
	1,608.3	1,305.2	1,149.0	1,233.1	1,077.1	1,019.0	570.0	664.8	N.A.	N.A.
Canadian Liquid Reserves	2,729.2	2,310.2	2,109.5	2,185.4	1,972.7	1,903.3	1,428.3	1,480.3	N.A.	N.A.
Liabilities:										
Canadian Deposits										
- Savings	7,853.4	7,424.7	7,236.9	7,009.8	6,225.0	6,098.2	5,838.7	5,337.2	5,147.7	4,900.9
- Demand	5,348.2	4,827.8	4,643.5	5,083.8	4,315.5	4,298.9	4,449.6	3,704.1	3,151.9	3,067.8
- Other	402.9	525.5	394.8	516.4	374.5	462.2	494.4	526.1	590.2	489.0
- Total	13,604.5	12,778.0	12,275.2	12,610.0	10,915.0	10,859.3	10.782.7	9,567.4	8,889.8	8,457.7
Foreign Deposits	3,715.5	3,052.3	2,529.2	2,166.9	1,713.4	1,334.3	1,048.4	985.8	1,029.0	987.9
Total Deposits	17,320.0	15,830.3	14.804.4	14,776.9	12,628.4	12,193.6	11,831.1	10.553.2	9,918.8	9,445.6
Miscellaneous	438.4	397.0	291.0	304.1	306.3	283.8	238.6	197.5	191.9	218.0
- Capital	274.9	265.4	253.9	222.2	211.7	195.2	181.0	167.0	151.0	148.6
- Rest Account	771.0	725.8	653.9	559.8	490.0	445.2	367.3	318.3	236.9	216.6
- Undivided Profit	8.7	6.7	10.2	7.2	9.2	6.2	11.3	9.3	7.8	12.9
Total Equity	1,054.6	997.9	918.0	789.2	710.9	646.6	559.6	494.6	395.7	378.1
	18,813.0	17,225.2	16,013.4	15,870.2	13,645.6	13,104.0	12,629.3	11,245.3	10,506.4	10,041.7

(1) In 1960 five banks ended their financial year on Oct. 31st, two on Nov. 30th, and one on Sept. 30th. (2) Source: Bank of Canada Annual Statistical Summary. (3) Source: Canada Gazette. (4) Includes secured day-to-day, call and short loans to investment dealers and brokers in Canadian Currency. Secondary reserves, however, normally exclude all but day-to-day loans in this total.

CANADIAN CHARTERED BANKS

E. & O. E.

EXHIBIT D
Table 2(a)

SELECTED CHARTERED BANK STATISTICS (000's omitted)

	1953	1952	1951	1950	1949	1948	1947	1946
Gov't. of Can. Treas. Bills	244,000	138,000	236,000	129,000	126,000	129,000	139,000	147,000
Gov't. of Can. Sec. Mat. 2 yrs.	482,000	869,000	499,000	694,000	763,000	656,000	482,000	1,052,000
Total	726,000	1,007,000	735,000	823,000	889,000	785,000	821,000	1,199,000
Gov't of Can. Sec. Maturing after 2 years	2,033,774	1,777,217	2,019,211	2,256,182	2,233,556	2,173,159	2,027,698	2,117,555
Cdn. Provincial Securities	334,339	379,052	355,121	415,586	445,316	475,704	467,745	316,449
Cdn. Municipal Securities	151,880	159,377	167,270	193,704	161,262	139,935	133,292	115,462
Other Cdn. Securities	348,696	377,413	399,296	405,277	383,549	451,603	353,855	207,188
Total	3,595,082	3,700,021	3,675,426	4,093,500	4,102,490	4,026,189	3,603,116	3,956,304
Char. Banks Total Assets	10,722,306	10,137,350	9,609,802	9,495,936	8,718,188	8,579,518	7,973,986	7,798,628
Gov't. of Can. Treas. Bills % Char. Bank Total Assets	2.28	1.36	2.46	1.36	1.45	1.50	1.74	1.88
Gov't. of Can. Sec. Mat. 2 yrs. % Char. Bank Total Assets	6.77	8.91	7.64	8.65	10.19	9.16	7.78	15.38
Gov't. of Can. Sec. Mat. after 2 years % Char. Bank Total Assets	18.97	17.50	21.01	23.76	25.50	25.33	25.43	27.15
Cdn. Prov. Securities % Char. Bank Total Assets	3.19	3.73	3.70	4.38	5.11	5.54	5.87	4.06
Cdn. Mun. Securities % Char. Bank Total Assets	1.42	1.57	1.74	2.04	1.85	1.63	1.67	1.48
Other Cdn. Securities % Char. Bank Total Assets	3.25	3.72	4.16	4.27	4.40	5.26	4.44	2.66
Char. Bank Total Securities % Total Assets	33.53	36.43	38.25	43.11	47.06	46.93	45.19	50.73
Gov't. of Can. Treas. Bills & Sec. Mat. within 2 yrs. % Char. Bks. Total Assets	6.77	8.91	7.64	8.66	10.19	9.16	7.78	15.38
Char. Banks Holdings of all Sec. except Treas. Bills and Canadas Mat. under 2 years	2,868,689	2,693,059	2,940,898	3,270,749	3,213,683	3,240,401	2,982,590	2,756,654
Char. Banks Holdings of all Sec. + Mtges. except Treas. Bills & Cdas. Mat. under 2 years	2,869,098	2,693,505	2,941,284	3,271,205	3,214,353	3,241,347	2,983,806	2,758,302
Char. Bks. Holdings of all Secs. + Mtges. except Treas. Bills and Cdas. Mat. under 2 yrs. % Pers. Sav. Dep.	56.99	54.70	63.78	71.76	72.50	79.90	79.77	79.51
Personal Savings Deposits	5,034,050	4,924,489	4,611,524	4,558,417	4,433,352	4,056,953	3,740,442	3,469,322
Demand Deposits	3,180,050	3,242,094	2,962,711	2,770,388	2,426,477	2,543,617	2,295,585	2,290,809
Other Deposits	849,713	412,493	481,433	616,622	461,462	464,018	404,874	516,602
Total Deposits	9,063,813	8,579,076	8,055,668	7,945,427	7,321,291	7,064,588	6,440,901	6,276,733
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Pers. Sav. Dep.	56.99	54.69	63.77	71.75	72.49	79.87	79.74	79.46
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Demand Deposits	90.21	83.07	99.26	118.06	132.44	127.39	129.93	120.34
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	31.65	31.39	36.51	41.17	43.90	45.87	46.31	43.92
Char. Bks. Holdings of all Secs. + Mtge. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	31.65	31.40	36.51	41.17	43.90	45.88	46.33	43.94

R. & O. R.

EXHIBIT D
Table 2(b)

SELECTED CHARTERED BANK STATISTICS (000's omitted)

	1961	1960	1959	1958	1957	1956	1955	1954
Gov't. of Can. Treas. Bills	1,156,888	967,209	973,807	949,705	804,964	739,600	427,464	359,799
Gov't. of Can. Sec. Mat. 2 years	1,088,500	615,288	657,484	826,069	409,853	406,096	475,089	635,592
Total	2,245,388	1,782,497	1,631,291	1,775,774	1,214,817	1,145,696	902,553	995,391
Gov't of Can. Sec. Maturing after 2 years	1,550,743	1,472,389	1,169,260	1,736,016	1,425,370	1,268,933	2,156,877	2,317,562
Cdn. Provincial Securities	351,980	323,819	346,168	415,151	285,011	268,981	322,478	263,508
Cdn. Municipal Securities	231,264	207,962	204,154	194,723	168,273	184,694	217,658	177,312
Other Cdn. Securities	470,319	473,009	512,401	553,994	508,753	510,112	481,916	353,332
Total	4,849,694	4,059,676	3,863,274	4,675,658	3,602,224	3,378,416	4,081,482	4,107,105
Char. Banks Total Assets	19,153,484	16,917,096	15,834,924	15,840,274	14,243,504	13,427,896	12,701,736	11,433,157
Gov't. of Can. Treas. Bills % Char. Bank Total Assets	6.04	5.72	6.15	6.00	5.65	5.51	3.37	3.15
Gov't. of Can. Sec. Mat. 2 years % Char. Bank Total Assets	5.68	3.64	4.15	5.21	2.88	3.02	3.74	5.56
Gov't of Can. Sec. Mat. after 2 years % Char. Bank Total Assets	8.10	8.70	7.38	10.96	10.01	9.45	16.98	20.27
Cdn. Prov. Securities % Char. Bank Total Assets	1.84	1.91	2.19	2.62	2.00	2.00	2.54	2.30
Cdn. Mun. Securities % Char. Bank Total Assets	1.21	1.23	1.29	1.23	1.18	1.38	1.71	1.55
Other Cdn. Securities % Char. Bank Total Assets	2.46	2.80	3.24	3.50	3.57	3.80	3.79	3.09
Char. Bank Total Securities % Total Assets	25.32	23.99	24.40	29.52	25.29	25.16	32.13	35.92
Gov't. of Can. Treas. Bills & Sec. Mat. within 2 yrs. % Char. Bks. Total Assets	11.72	10.54	10.30	11.21	11.73	8.53	7.11	8.71
Char. Banks Holdings of all Sec. except Treas. Bills and Canadas Mat. under 2 years	2,604,306	2,277,179	2,231,983	2,890,884	2,387,407	2,232,720	3,178,929	3,111,714
Char. Banks Holdings of all Secs. + Mtges. except Treas. Bills & Cdas. Mat. under 2 yrs.	3,556,977	3,247,771	3,199,853	3,689,613	2,973,213	2,725,897	3,472,592	3,185,954
Char. Banks Holdings of all Secs. + Mtges. except Treas. Bills and Cdas. Mat under 2 yrs. % Pers. Sav. Dep.	46.69	45.02	46.38	53.91	48.68	45.38	61.65	61.06
Personal Savings Deposits	7,618,100	7,214,692	6,899,639	6,843,687	6,107,930	6,007,180	5,632,752	5,217,717
Demand Deposits	5,629,516	4,877,215	4,701,895	5,254,311	4,642,988	4,624,522	4,378,845	3,994,596
Other Deposits	938,363	820,268	677,598	592,219	656,104	530,637	836,520	470,493
Total Deposits	14,185,979	12,912,175	12,279,132	12,690,217	11,407,022	11,162,339	10,848,117	9,682,806
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat under 2 yrs % Pers. Sav. Dep.	34.19	31.56	32.35	42.37	39.09	37.18	56.44	59.64
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Demand Deposits	46.26	46.69	47.47	55.19	51.42	48.28	72.80	77.90
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	18.36	17.64	18.18	22.85	20.93	20.00	29.30	32.14
Char. Bks. Holdings of all Secs. + Mtge. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	25.07	25.15	26.06	29.07	26.06	24.42	32.01	32.90

L. & O. K.

A.494
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EXHIBIT "E"

EXCERPT FROM THE BANK OF CANADA ANNUAL REPORT 1956

THE BANKING SYSTEM

1. One reason why it is not possible to predict the effects of monetary measures with accuracy is the uncertainty, which must always exist to some degree, as to the reaction of the banking system itself to such measures. In Canada this has been more noticeable perhaps than elsewhere because of the extent to which commercial banking functions and savings banking functions are intermingled in the operations of the chartered banks. Over 80 per cent of total personal savings deposits in Canada are held with the chartered banks, and the pattern of investment of such deposits has varied widely at different times. The banks may under conditions of inflationary pressure expand their commercial and general loans and other forms of short-term credit from such funds, which in other times would go into long-term investments, including (since 1954) housing loans. This has happened in each of the postwar credit expansion cycles (1947-48, 1950-51, 1952-53 and 1955-56).

2. The possibility of such a development has made it necessary for the central bank to regard the total volume of deposits of the chartered banks, including personal savings deposits, as forming part of the money supply, whereas the savings deposits held with specialized savings institutions (e.g. trust companies, loan companies, savings banks, credit unions) are not so regarded. At a time of strong demand for short-term credit, therefore, the central bank must endeavour to restrain any increase

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EXCERPT FROM THE BANK OF CANADA ANNUAL REPORT 1956

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in total bank deposits, to such a degree that the natural and virtually unavoidable increase in personal savings deposits is laregely or at times entirely matched by a decline in other deposits.

3. Even so, the effects on credit expansion of any particular degree of restraint on monetary expansion cannot be predicted with confidence, because of the availability for commercial and general loans of funds that can be obtained by the banks by selling in large volume the Government securities in which a considerable proportion of their savings deposits had previously been invested. By this means, the greater part of the resources of the banks' savings departments have been available as required from time to time to agument the other resources of the banks' commercial banking departments when the demand for commercial loans has been particularly great. Housing loans and other investments have been the residual form of investment for the savings departments of the banks.

4. In other countries personal savings deposits are chiefly held by separate and specialized institutions, sometimes called building societies, sometimes called savings and loan associations, sometimes called savings banks or mutual savings banks, which make a practice of investing such funds in housing loans and in relatively long-term securities. Their objective is to invest to the best advantage in order to obtain the largest revenue consistent with prudent investment practices, and in order thereby to be able to pay the highest possible rate of interest to their depositors. Experience has

Page 498-H to follow

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shown that rarely if ever does a savings institution encounter an actual decline in its total volume of deposits, other than purely temporary or seasonal fluctuations which a reasonable degree of liquidity in its assets will permit it to meet without having to run the risk of losses through sales of long-term investments prior to maturity. The great bulk of personal savings deposits, increasing from year to year, are accordingly invested in non-commercial-banking types of loans and investments, and the central bank does not regard such deposits as part of the supply of "money" that need be directly influenced by monetary operations.

5. The different evolution of the Canadian banking structure has created problems relating both to fluctuations in short-term credit and to fluctuations in long-term investment. Until 1954 the Canadian chartered banks were not permitted by law to lend money on housing or other forms of real estate, presumably because they were primarily regarded as commercial banks. Because of their efficient operation of a widespread branch system in a large sparsely settled country they managed to attract most of the personal savings deposits of the people, and these became increasingly important as the country developed. The increase in the chartered banks' savings deposits has averaged $340 million a year over the last five years and will no doubt continue to rise in the future. Specialized savings institutions grew much more slowly, and mainly in the large cities. The kind of investments such institutions might have made were for the most part not

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made by the chartered banks.

6. In 1954 the Bank Act was amended to permit the chartered banks to make mortgage loans on new houses, loans insured under the National Housing Act. This was an important improvement in the machinery of the Canadian capital market. I believe it would be desirable if means could now be found to encourage greater stability in the rate of long-term investment by the banks in those fields where they may now operate.

7. It may be that specialized savings institutions, which invest their fund in housing loans and other long-term investments and are able thereby to pay higher rates of interest on savings deposits than the chartered banks, will grow in importance and attract a growing part of the future personal savings of Canadians. To maintain their relative position, the chartered banks may find it desirable and necessary to operate in respect of the resources of their savings departments in much the same way as a savings bank and use such resources to provide funds for the kinds of investment naturally associated with long-term savings.

8. To the extent that personal savings were segregated from the commercial lending field, they could be regarded as likewise removed from the category of "money supply". The banks' short-term credit operations would become more responsive to changes in monetary conditions. It would, of course, be the duty of the central bank -- as it is today -- to see that sufficient money was made available to permit an adequate volume of short-term credit to be provided through the

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banking system. The volume of short-term loans might not be any different from what it has been, on the average and allowing for normal growth, but a tendency towards excessive expansion in periods of inflationary pressures would be more readily restrained. Fluctuations in mortgage lending would of course be much less pronounced. The workings of monetary policy would become more predictable and more effective. The possibility of a gradual approach towards arrangements of the sort outlined would seem to be worthy of study and discussion. Progress in such an approach would be directed towards expanding mortgage loans and other appropriate investments based on future increases in savings deposits, not reducing the volume of commercial or general loans.

Bank of Canada Annual Report 1956 (pages 27-31).

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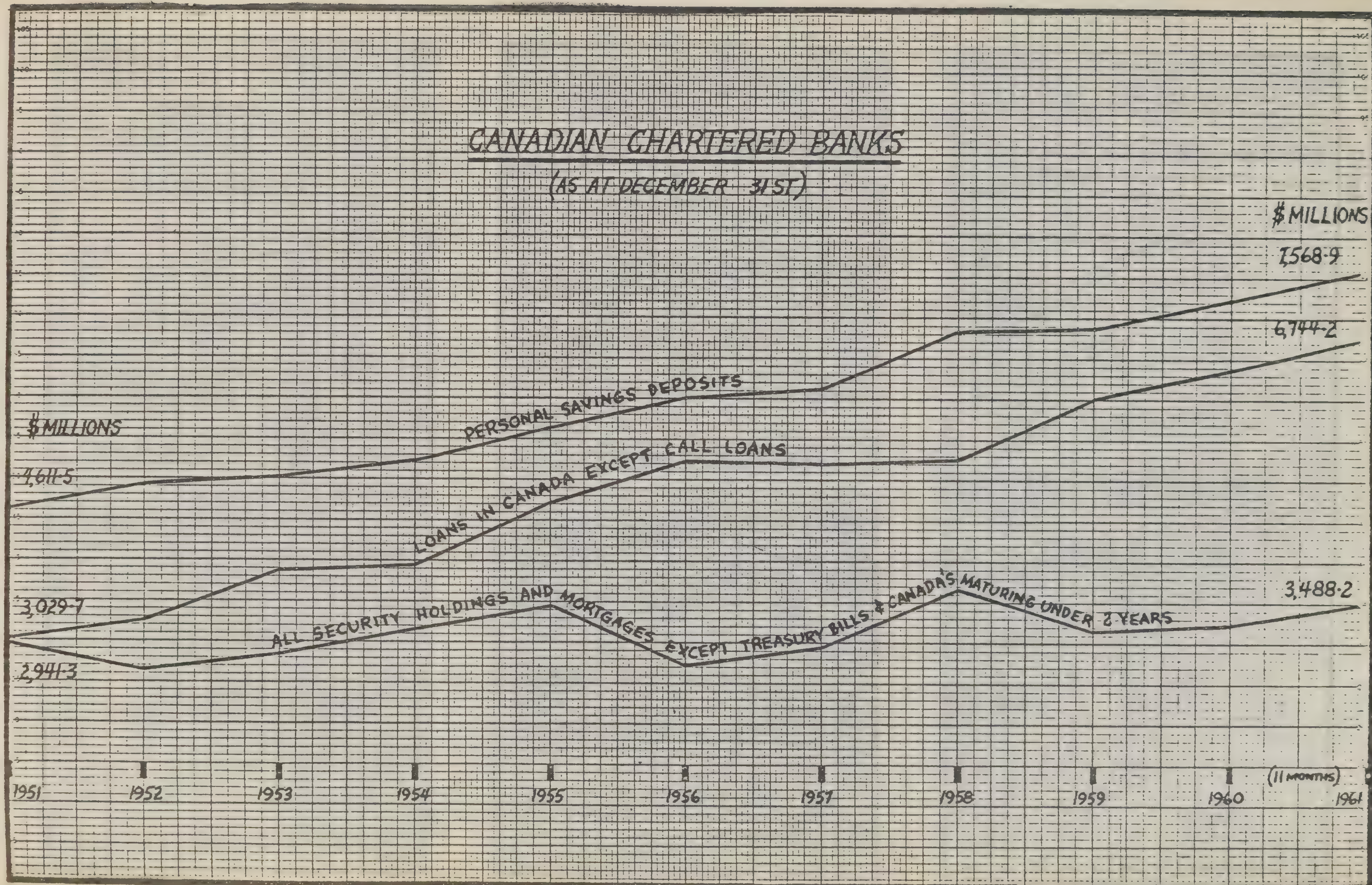
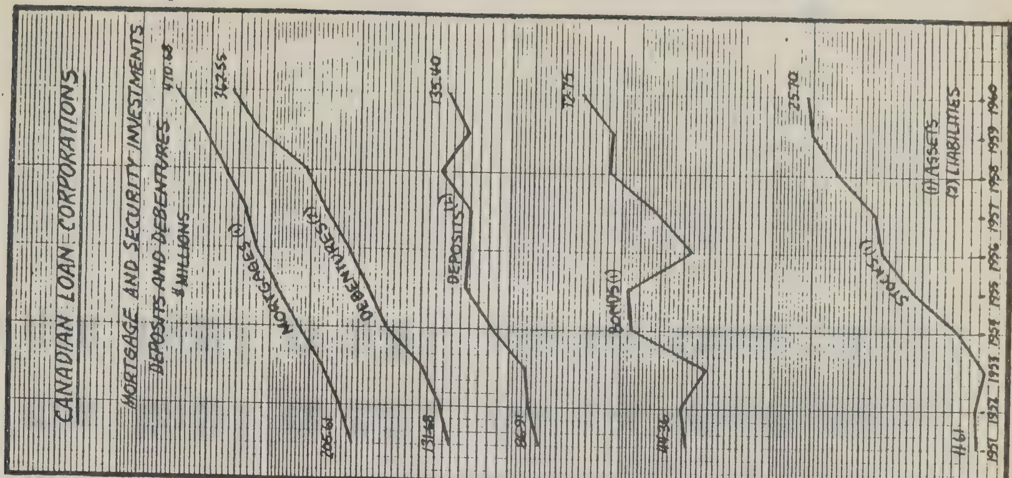
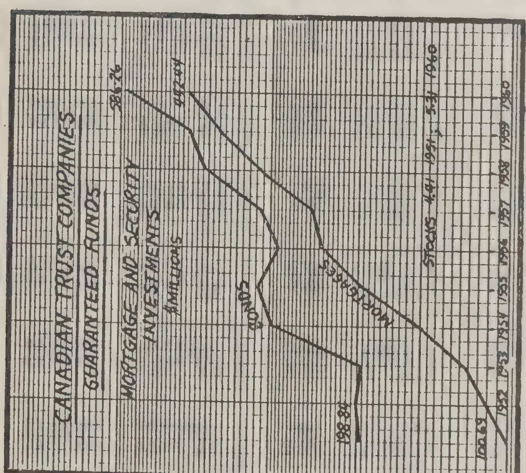
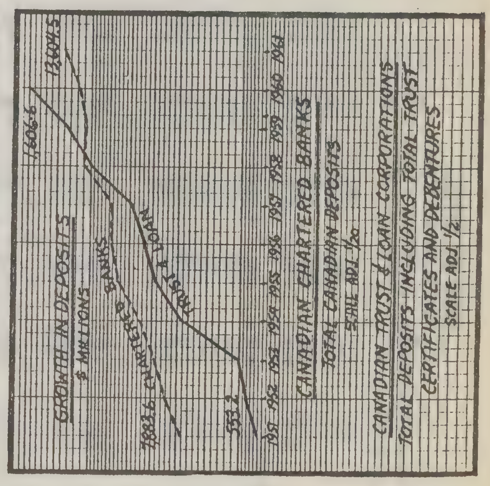
Bank of Canada Annual Report 1956 (pages 27-31):

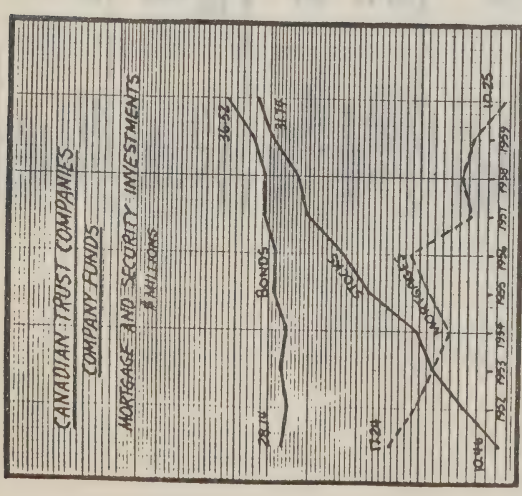
EXHIBIT F

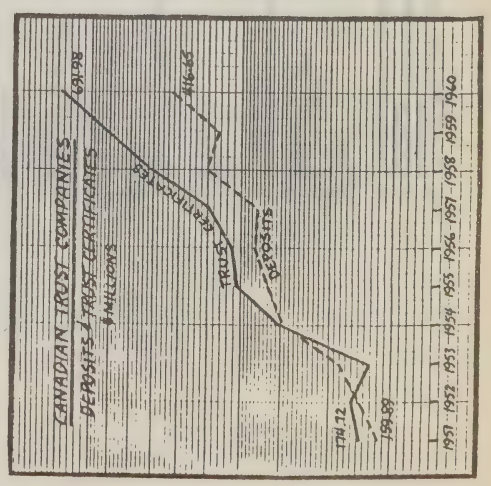

CANADIAN CHARTERED BANKS
(AS AT DECEMBER 31ST)
$ MILLIONS
7,568·9
6,744·2
3,488·2
$ MILLIONS
4,611·5
3,029·7
2,941·3
PERSONAL SAVINGS DEPOSITS
LOANS IN CANADA EXCEPT CALL LOANS
ALL SECURITY HOLDINGS AND MORTGAGES EXCEPT TREASURY BILLS & CANADA'S MATURING UNDER 2 YEARS
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
(11 MONTHS)
1961

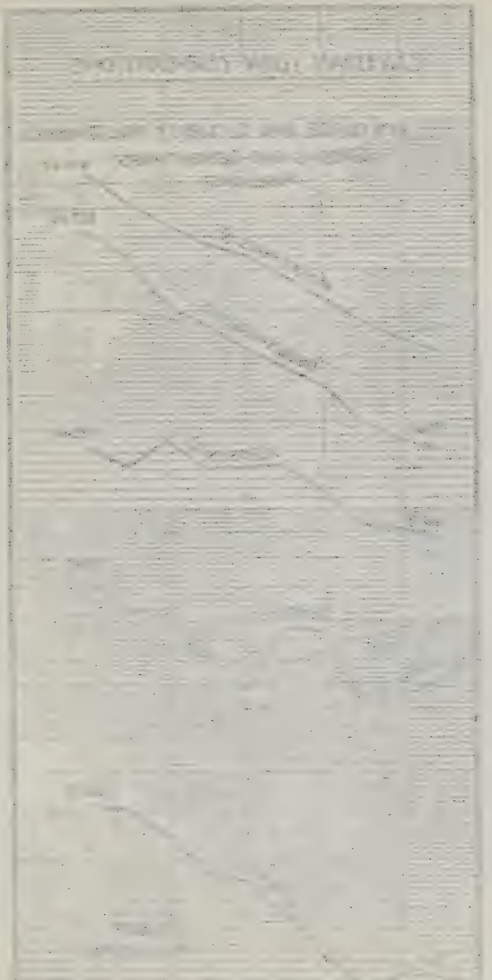

CANADIAN LOAN CORPORATIONS
MORTGAGE AND SECURITY INVESTMENTS
DEPOSITS AND DEBENTURES
$ MILLIONS
MORTGAGES (1)
DEBENTURES (2)
DEPOSITS (2)
BONDS (1)
STOCKS (1)
(1) ASSETS
(2) LIABILITIES
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960

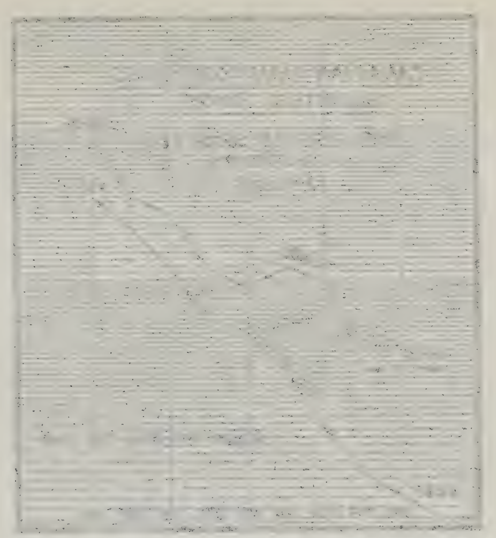

CANADIAN TRUST COMPANIES
GUARANTEED FUNDS
MORTGAGE AND SECURITY INVESTMENTS
$ MILLIONS
BONDS
MORTGAGES
1952 1953 1954 1955 1956 1957 1958 1959 1960


GROWTH IN DEPOSITS
$ MILLIONS
CHARTERED BANKS
TRUST & LOAN
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960 1961
CANADIAN CHARTERED BANKS
TOTAL CANADIAN DEPOSITS
CANADIAN TRUST & LOAN CORPORATIONS
TOTAL DEPOSITS INCLUDING TOTAL TRUST CERTIFICATES AND DEBENTURES


CANADIAN TRUST COMPANIES
COMPANY FUNDS
MORTGAGE AND SECURITY INVESTMENTS
$ MILLIONS
BONDS
STOCKS
MORTGAGES
1952 1953 1954 1955 1956 1957 1958 1959


CANADIAN TRUST COMPANIES
DEPOSITS & TRUST CERTIFICATES
$ MILLIONS
TRUST CERTIFICATES
DEPOSITS
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960





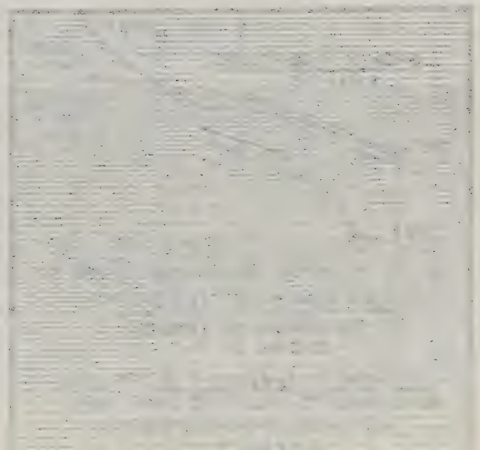


EXHIBIT G
Table 1

CANADIAN TRUST COMPANIES (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Company Funds										
Mortgages	10.26	11.84	12.45	11.80	15.76	14.43	13.14	14.19	15.35	17.34
Securities	66.26	62.15	57.24	56.19	50.50	48.14	43.08	42.70	39.96	38.60
Loans	5.70	6.56	5.70	5.48	5.61	4.97	5.02	4.50	5.28	4.89
Cash	7.06	5.25	6.15	4.11	4.36	4.30	4.96	4.11	3.24	3.17
Other Assets (1)	23.70	23.19	20.69	20.02	18.61	15.75	15.01	13.74	12.95	13.06
Total Assets	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
(1) Includes office premises and real estate held for sale.										
Guaranteed Funds										
Mortgages	442.44	381.42	316.57	247.42	238.34	190.45	152.30	123.78	110.80	100.60
Securities	581.57	442.37	411.51	317.74	295.31	322.16	302.25	200.23	203.35	203.25
Loans	45.86	41.60	48.46	33.67	26.42	29.56	26.18	13.83	14.87	15.30
Cash	30.45	34.64	29.80	30.77	37.38	36.20	24.18	18.98	25.94	16.10
Other Assets	—	.13	.08	—	—	—	—	2.48	—	(.04)
Total Assets	1,110.32	900.18	806.31	629.60	597.55	577.36	504.92	359.40	355.05	335.30
Grand Total Assets	1,225.89	1,009.19	908.54	727.33	692.39	665.15	586.07	438.64	431.75	412.26
Estates, Trusts & Agency Funds	7,068.90	6,613.23	6,020.54	5,290.16	4,818.04	4,416.45	4,125.80	3,882.62	3,731.93	3,593.38
Liabilities										
Company Funds										
Equity (2)	100.06	95.34	88.35	84.18	80.89	74.91	67.97	66.78	64.86	64.22
Other Liabilities	15.51	13.67	13.88	13.55	13.95	12.88	13.18	12.46	11.84	12.74
Total Liabilities	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
Guaranteed Funds										
Deposits	416.65	337.85	350.42	279.10	281.94	266.80	249.46	191.89	174.33	159.89
Trust Certificates	691.98	561.10	454.90	349.57	314.56	309.86	254.93	166.74	180.08	174.72
Other Liabilities	1.69	1.23	.99	.93	1.05	.70	.54	.77	.64	.69
Total Liabilities	1,110.32	900.18	806.31	629.60	597.55	577.36	504.92	359.40	355.05	335.30
Grand Total Liabilities	1,225.89	1,009.19	908.54	727.33	692.39	665.15	586.07	438.64	431.75	412.26
(2) Includes reserve fund and contingency reserve of: ($ millions)	54.33	49.56	43.34	40.52	38.16	35.41	31.19	28.85	28.30	27.35
Earnings ($ millions)										
Guaranteed Fund										
Revenue										
- mortgages	27.10	21.90	17.22	14.89	13.04	10.25	7.85	6.44	5.61	4.83
- securities (3)	27.89	18.05	14.99	12.30	10.64	10.53	8.93	6.80	6.11	5.60
- loans	2.51	1.86	1.81	1.31	1.19	.92	.68	.54	.73	.58
- other revenue	.30	.15	.15	.23	.13	.27	.16	.09	.09	.08
	57.80	41.96	34.17	28.73	25.00	21.97	17.62	13.87	12.54	11.09
Expenditures										
- interest paid on deposits	11.67	9.82	8.36	7.68	6.03	5.42	4.72	3.38	2.78	2.41
- interest pd. on trust cert.	30.79	19.73	15.08	12.00	9.70	7.81	6.20	4.75	4.42	3.96
- other expenses	.72	.62	.60	.40	1.07	.84	.25	.18	.07	.09
	43.18	30.17	24.04	20.08	16.80	14.07	11.17	8.31	7.27	6.46
Profit on Guaranteed Funds	14.62	11.79	10.13	8.65	8.20	7.90	6.45	5.56	5.27	4.63
Company Fund										
Revenue										
- estates trusts agency fees etc	37.17	35.38	32.55	29.96	27.00	24.20	21.14	19.36	17.90	17.04
- profit in guar. funds	14.62	11.79	10.13	8.65	8.20	7.90	6.45	5.56	5.27	4.63
	51.79	47.17	42.68	38.61	35.20	32.10	27.59	24.92	23.17	21.67
- mortgages	.92	.86	.93	.93	1.00	.78	.82	.84	.95	.91
- securities (3)	3.89	3.62	3.54	2.71	2.80	2.50	2.30	1.89	1.94	2.09
- loans	.50	.47	.37	.40	.39	.36	.30	.36	.26	.27
- other revenue	2.14	1.64	1.59	1.42	1.17	1.00	.97	.84	.75	.73
	7.45	6.59	6.43	5.46	5.36	4.64	4.39	3.93	3.90	4.00
Total Revenue	59.24	53.76	49.11	44.07	40.56	36.74	31.98	28.85	27.07	25.67
(3) Includes net profit or loss on sale of securities.										
Expenditures (4) (5)	43.91	39.98	36.76	33.32	30.36	27.09	23.44	21.58	23.53(6)	22.39(6)
Net Earnings before Taxes	15.33	13.78	12.35	10.75	10.20	9.65	8.54	7.26	3.54	3.28
Less: Income Taxes	7.05	6.12	5.03	4.52	3.99	4.12	3.78	3.08	N.A.	N.A.
Net Profit	8.28	7.66	7.32	6.23	6.21	5.53	4.76	4.17	3.54	3.28
Dividends	5.00	4.50	4.19	3.90	3.55	3.18	2.88	2.79	2.75	2.70
Balance	3.28	3.16	3.13	2.33	2.66	2.35	1.88	1.38	.79	.58
(4) Includes net amounts transferred to investment reserves of: ($ millions)	1.12	.98	1.04	.77	1.14	1.03	.43	.43	.57	1.06
(5) Includes net amounts by which ledger values of assets were written down. ($ millions)	.13	.13	.20	.11	.13	.12	.13	.10	.18	.16

(6) Includes unstated income taxes.

(Composite of 23 Trust Companies)
CANADIAN TRUST COMPANIES

E. & O. E.

EXHIBIT G
Table 2

CANADIAN TRUST COMPANIES (as at December 31st)

Ratios	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Guaranteed Fund % Total Assets	90.57	89.20	88.75	86.56	86.30	86.80	86.15	81.94	82.24	81.33
Guaranteed Fund Mortgages % Total Guar. Fund Assets	39.85	42.37	39.26	39.30	39.87	34.55	30.16	34.44	31.23	30.03
Guaranteed Fund Securities % Total Guaranteed Fund Assets	53.28	49.14	51.04	50.47	49.42	55.80	59.86	55.71	57.27	60.62
Deposits % Guaranteed Funds	37.52	37.53	43.46	44.33	47.18	46.21	49.40	53.39	49.10	47.69
Equity % Guaranteed Fund*	9.01	10.59	10.96	13.37	13.54	12.97	13.46	18.58	18.27	19.15
Company Fund Mortgages % Total Company Fund Assets	8.87	10.86	12.18	12.21	16.62	16.44	16.19	17.91	19.88	22.40
Company Fund Securities % Total Company Fund Assets	59.06	57.01	55.99	57.50	53.25	54.84	53.03	53.89	52.13	50.16
Revenue from Estates, Trusts, etc. % Total under Administration	0.53	0.53	0.54	0.57	0.56	0.55	0.51	0.50	0.48	0.47
Profit in Guaranteed Funds % Total Assets Guar. Fund	1.32	1.31	1.26	1.37	1.37	1.37	1.28	1.55	1.48	1.38
Company Fund Mortgage Rev. % Mortgage Investment	8.98	7.26	7.47	7.80	6.35	5.41	6.24	5.92	6.23	5.28
Company Fund Securities Rev. % Securities Investment	5.70	5.82	6.18	4.82	5.54	5.19	5.35	4.43	4.85	5.41
Company Fund Revenues % Company Fund Assets	6.45	6.05	6.29	5.59	5.65	5.29	5.41	4.96	5.08	5.20
Expenditures % Revenue	74.12	74.37	74.85	75.61	74.85	73.73	73.30	74.84	N.A.	N.A.
Net Profit % Equity	8.28	8.03	5.69	5.37	4.93	7.38	7.00	6.24	5.46	5.11
Dividend % Net Profit	60.39	58.75	57.24	62.60	57.17	57.50	60.50	66.91	77.68	82.32

* Borrowing power on debentures and other securities and by way of deposits, by law, is limited to 12½ times (8%) of Paid-up Capital and Reserve (equity.)

Source: Report of the Registrar of Loan and Trust Corporations for the Province of Ontario. The report includes the particulars of the business of each trust company registered and conducting business in Ontario comprised of the following twenty-three companies in 1960, listed in order of size of total assets, including estates, trusts and agency funds under administration, in $ millions.

1. Royal Trust Co.	2,461.83	9.	Guaranty Trust Co.	249.83	17.	Premier Trust Co.	28.96
2. Montreal Trust Co.	1,817.03	10.	Crown Trust Co.	240.08	18.	Prudential Trust Co.	21.24
3. National Trust Co.	837.80	11.	Canada Permanent Trust Co.	205.91	19.	Industrial Mortgage & Tr. Co.	20.94
4. Toronto General Trusts Corp.	607.85	12.	Chartered Trust Co.	182.48	20.	Investors Trust Co.	13.95
5. Canada Trust Co.	491.20	13.	Waterloo Trust & Savings Co.	110.37	21.	Halton & Peel Trust & Sav. Co.	12.35
6. Administration and Trust Co.	301.89	14.	Victoria and Grey Trust Co.	99.33	22.	Lambton Trust Co.	3.83
7. Eastern Trust Co.	254.78	15.	British Mortgage & Trust Co.	44.72	23.	Bankers' Trust Co.	.43
8. General Trust of Canada	252.03	16.	Sterling Trusts Corp.	35.96			

CANADIAN TRUST COMPANIES

E. & O. E.

EXHIBIT G
Table 3

CANADIAN TRUST COMPANIES (as at December 31st)

Assets Invested in Securities ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Company Funds										
- Bonds	36.52	32.21	30.86	30.83	29.12	29.13	27.76	28.26	27.59	28.14
- Stocks	31.74	29.94	26.38	25.36	21.38	19.01	15.27	14.44	12.39	10.46
Total Securities	68.26	62.15	57.24	56.19	50.50	48.14	43.03	42.70	39.98	38.60
Total Co. Fund Assets	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
Guaranteed Funds										
- Bonds	586.26	438.17	407.27	314.28	291.57	318.75	299.37	197.75	200.01	198.84
- Stocks	5.31	4.20	4.24	3.46	3.74	3.41	2.88	2.48	3.34	4.41
Total Securities	591.57	442.37	411.51	317.74	295.31	322.16	302.25	200.23	203.35	203.25
Total Guar. Fund Assets	1,110.32	900.18	806.31	639.60	597.55	577.38	504.92	359.40	355.05	335.30
Totals of Both Funds										
- Bonds	622.78	470.38	438.13	345.11	320.69	347.88	327.13	226.01	227.60	226.98
- Stocks	37.05	34.14	30.62	28.82	25.12	22.42	18.15	16.92	15.73	14.87
Total Securities	659.83	504.52	468.75	373.93	345.81	370.30	345.28	242.93	243,33	241.85
Total Assets Both Funds	1,225.89	1,009.19	908.54	737.33	692.39	665.15	586.07	438.64	431.75	412.26
Revenue from Securities (1) ($ millions)										
Company Funds										
- Bonds	1.81	1.55	1.40	1.24	1.17	1.07	1.01	1.01	.95	.99
- Stocks	1.70	1.67	1.39	1.24	1.07	.96	.83	.72	.69	.60
Total	3.51	3.22	2.79	2.48	2.24	2.03	1.84	1.73	1.64	1.59
Guaranteed Funds										
- Bonds	27.52	18.36	14.88	12.49	10.92	10.68	8.40	7.17	6.49	5.94
- Stocks	.11	.11	.18	.15	.16	.18	.15	.15	.18	.20
Total	27.63	18.47	15.06	12.64	11.08	10.86	8.55	7.32	6.67	6.14

(1) Excludes profit (or loss) on sale of securities.

	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Totals of Both Funds										
- Bonds	29.33	19.91	16.28	13.73	12.09	11.75	9.41	8.18	7.44	6.93
- Stocks	1.81	1.78	1.57	1.39	1.23	1.14	.98	.87	.87	.80
Total Revenue	31.14	21.69	17.85	15.12	13.32	12.89	10.39	9.05	8.31	7.73
Ratios										
Company Funds										
Bonds % Co. Fund Assets	31.60	29.55	30.19	31.54	30.70	33.18	34.21	35.66	35.97	36.56
Stocks % Co. Fund Assets	27.46	27.46	25.80	25.94	22.54	21.65	18.82	18.22	16.15	13.59
Guaranteed Funds										
Bonds % Guar. Fund Assets	52.80	48.68	50.51	49.92	48.79	55.21	59.29	55.02	56.33	59.30
Stocks % Guar. Fund Assets	.48	.47	.53	.55	.63	.59	.57	.69	.94	1.32
Bonds % Total Assets Both Funds	50.80	46.61	48.22	47.45	46.32	52.30	55.82	51.53	52.72	55.06
Stocks % Total Assets Both Funds	3.02	3.38	3.37	3.96	3.63	3.37	3.10	3.86	3.64	3.61
Income Yields (2)										
Company Funds										
- Bonds	4.96	4.81	4.54	4.02	4.02	3.67	3.64	3.57	3.44	3.52
- Stocks	5.36	5.58	5.27	4.89	5.00	5.05	5.44	4.99	5.57	5.74
Guaranteed Funds										
- Bonds	4.69	4.19	3.65	3.97	3.75	3.35	2.81	3.63	3.24	2.99
- Stocks	2.07	2.62	4.25	4.34	4.28	5.28	5.21	6.05	5.39	4.54
Yields of Both Funds										
- Bonds	4.71	4.23	3.72	3.98	3.77	3.38	2.88	3.62	3.27	3.05
- Stocks	4.89	5.21	5.13	4.82	4.90	5.08	5.40	5.14	5.53	5.38
Total Securities	4.72	4.30	3.81	4.06	3.85	3.48	3.01	3.73	3.42	3.20

(2) Calculated on 1960 revenues as a percentage of book value of security investments outstanding as at December 31st, 1960 and is, therefore, not a weighted average return on investment.

EXHIBIT G
Table 4

SELECTED CANADIAN TRUST COMPANIES (as at December 31st, 1960)

Assets ($ millions)	Industry (23 cos.)	Chartered Trust	Crown Trust	Eastern Trust	Guaranty Trust	Industrial Mtge & Trust	Montreal Trust	National Trust	Premier Trust	Royal Trust	Victoria & Grey Trust	Waterloo Trust
Company Funds												
- Mortgages	10.25	.02	—	1.05	—	.23	.90	—	.40	1.67	.19	—
- Bonds	36.32	3.15	2.06	1.50	4.37	.34	2.81	1.62	1.14	5.04	.44	1.02
- Stocks	31.74	.96	.93	.76	1.99	.10	4.96	3.55	.11	5.32	3.78	1.83
Total Co. Fund Assets	115.57	5.50	4.17	4.23	8.23	1.42	13.28	7.73	2.06	23.25	5.87	4.40
Guaranteed Funds												
- Mortgages	442.44	22.40	21.60	16.49	45.27	8.84	25.03	43.85	15.07	23.99	43.01	30.31
- Bonds	586.26	21.13	13.03	22.04	45.20	5.67	92.61	64.14	2.79	133.74	27.32	32.54
- Stocks	5.21	—	.08	.36	1.54	.11	—	2.28	—	—	—	—
Total Guar. Fund Assets	1,100.32	44.72	37.04	41.25	94.87	15.15	129.54	112.51	19.66	186.43	71.81	65.76
Grand Total Assets	1,225.89	50.22	41.21	45.51	103.10	16.57	142.82	120.24	21.72	209.68	77.68	70.16
Estates, Trusts & Agency Funds	7,068.90	132.26	198.87	209.27	146.73	4.37	1,674.21	717.56	7.24	2,252.15	21.65	40.21
Liabilities ($ millions)												
Company Funds												
- Equity	100.06	4.51	4.01	3.20	7.51	1.35	11.94	7.19	1.94	16.25	5.19	4.20
Guaranteed Funds												
- Deposits	416.65	26.56	17.95	10.38	47.14	6.78	10.67	97.83	3.07	—	22.42	37.31
- Trust Certificates	691.98	17.80	19.09	30.90	47.73	8.37	118.88	14.68	16.39	186.37	49.37	28.44
Revenue ($ millions)												
Estates, Trusts etc.	37.17	1.86	2.06	1.12	1.42	.02	6.59	4.76	.12	8.98	.10	.29
Profit in Guar. Fund	14.62	.72	.70	.48	1.36	.28	1.20	1.87	.56	1.35	1.33	1.12
Company Funds												
- Mortgages	.92	.01	—	.07	—	.03	.06	—	.04	.10	.01	—
- Bonds (1)	1.81	.14	.10	.06	.22	.01	.09	.07	.03	.33	.04	.06
- Stocks (1)	1.70	.04	.04	.03	.09	.04	.25	.25	.02	.27	.24	.09
(1) Includes net profit or loss on sale of securities.												
Total Revenue	59.24	2.82	3.04	1.76	3.20	.37	8.71	7.17	.81	11.62	1.84	1.72
Expenditures	43.91	2.10	2.43	1.40	1.82	.23	6.57	5.99	.40	8.77	1.04	1.17
Net Earnings before Taxes	15.33	.72	.61	.36	1.38	.14	2.14	1.18	.41	2.85	.80	.55
Income Taxes	7.05	.35	.28	.15	.60	.06	.95	.54	.20	1.33	.33	.26
Net Profit	8.28	.27	.33	.21	.78	.08	1.19	.64	.21	1.52	.47	.29
Dividends	5.00	.18	.15	.14	.28	.07	.69	.57	.10	.96	.34	.18
Ratios												
Co. Mtges. % Co. Fund Assets	8.87	.36	—	24.82	—	16.20	6.77	—	19.42	7.18	3.24	—
Co. Bonds % Co. Fund Assets	31.60	57.27	49.88	35.46	53.10	23.94	21.16	20.96	55.34	21.68	7.50	23.18
Co. Stocks % Co. Fund Assets	27.46	17.82	22.30	17.97	24.18	7.04	37.50	45.92	5.34	23.74	64.40	41.59
Guar. Mtges % Guar. Fund Assets	39.85	50.09	58.32	39.95	47.72	58.35	19.32	38.97	76.65	12.87	59.89	46.09
Guar. Bonds % Guar. Fund Assets	52.80	47.25	35.18	53.39	45.54	37.43	71.49	57.01	14.19	71.74	38.04	49.48
Guar. Fund % Grand Total Assets	90.57	89.05	89.88	90.71	92.02	91.43	90.70	93.57	90.52	88.91	92.44	93.73
Deposits % Guar. Fund	37.53	59.39	48.46	25.15	49.69	44.75	8.23	86.95	15.62	—	31.22	56.74
Trust Certs. % Guar. Fund	62.32	39.80	51.54	74.85	50.31	55.25	91.77	13.05	84.38	99.97	68.75	43.25
Equity % Guar. Fund	9.01	10.08	10.83	7.75	7.92	8.91	9.22	6.39	9.87	8.72	7.23	6.39
Revenue from Estates etc. % Total Under Administration	.53	1.41	1.04	.54	.97	.46	.39	.66	1.66	.40	.46	.72
Profit in Guar. Funds % Total Guar. Fund Assets	1.32	1.61	1.89	1.16	1.43	1.85	.93	1.40	2.85	.72	1.85	1.70
Income Yield on Co. Mtges. (2)	8.98		—	6.67	—	13.04	6.67	—	11.06	5.99	5.26	—
Income Yield on Co. Bonds (2)	4.96	4.44	4.81	3.33	5.03	2.94	3.20	4.32	2.63	6.55	9.09	5.88
Income Yield on Co. Stocks (2)	5.36	4.08	4.30	3.95	4.52	4.65	5.02	7.04	18.98	4.89	6.35	4.92
Revenue (excluding rev. from estates) % Grand Total Assets	1.80	1.91	2.38	1.41	1.73	2.11	1.48	2.00	3.18	1.26	2.24	2.04
Expenditures % Revenue	74.12	74.47	79.93	79.55	56.88	62.16	75.43	83.54	49.38	75.47	56.52	68.02
Net Profit % Grand Total Assets	.68	.74	.80	.46	.76	.48	.83	.53	.97	.72	.61	.41
Net Profit % Equity	8.28	8.20	8.23	6.56	10.39	5.93	9.97	8.90	10.82	9.35	9.06	6.90
Dividend % Net Profit	60.39	48.65	45.45	66.67	35.90	87.50	57.98	89.06	47.62	63.16	72.34	62.07

(2) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960 and is, therefore, not a weighted average return on investment.

E. & O. E.

EXHIBIT C
Table 5

CANADIAN LOAN CORPORATIONS (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Mortgages	470.68	415.61	373.05	338.70	325.08	294.03	264.35	236.70	217.96	205.61
Bonds	72.75	62.85	63.89	51.44	43.39	58.10	57.74	40.74	45.47	44.36
Stocks	25.70	25.14	22.25	18.75	18.07	15.87	12.87	11.23	11.69	11.61
Loans	1.42	3.04	.96	.37	3.19	4.14	1.72	2.50	1.83	.70
Cash	9.96	12.60	8.87	9.86	8.38	10.04	9.48	8.70	9.85	13.16
Other Assets	12.50	12.42	11.92	11.54	10.12	8.51	8.60	8.81	8.96	8.54
Total Assets	593.01	530.66	480.96	431.86	408.43	390.69	354.76	308.68	295.76	283.98
Liabilities										
Deposits	135.40	123.43	139.50	120.27	121.44	122.07	107.85	92.65	91.38	86.91
Debentures	362.55	320.21	256.88	233.64	209.75	190.66	175.48	148.72	137.92	131.68
Other	15.83	10.92	7.81	21.83	8.90	26.40	21.66	18.25	18.94	18.37
Liabilities to Public	513.78	454.56	404.19	375.74	340.09	339.13	304.99	259.63	248.24	236.96
Capital Stock	31.99	29.87	30.00	29.00	29.00	28.00	27.75	27.75	27.17	27.27
General Reserve	44.13	42.62	42.92	23.78	36.19	20.67	19.56	18.52	18.12	17.34
Undivided Profit	3.11	3.61	3.85	3.34	3.15	2.89	2.46	2.78	2.23	2.41
Equity	79.23	76.10	76.77	56.12	68.34	51.56	49.77	49.05	47.52	47.02
Total Liabilities	593.01	530.66	480.96	431.86	408.43	390.69	354.76	308.68	295.76	283.98
Earnings ($ millions)										
Revenue										
Mortgages	31.30	27.24	23.88	22.12	19.87	17.52	15.32	13.32	12.05	11.12
Bonds	3.11	2.59	2.34	1.57	1.78	1.98	1.73	1.43	1.49	1.42
Stocks	1.47	1.27	.99	.92	.90	.78	.63	.59	.61	.65
Loans	.15	.10	.06	.02	.02	.03	.01	.01	.01	.01
Other Revenue (1)	2.82	2.60	3.13	1.71	1.53	1.83	1.78	1.61	1.47	1.32
	38.75	33.80	30.41	26.34	24.10	22.14	19.47	16.96	15.63	14.52

(1) Includes net profit (or loss) on sale of secuirites and real estate.

	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
(dollars)	852,605	349,702	312,964	340,591	213,948	803,927	543,487	136,947	166,266	245,612
Expenditures	29.55	25.04	21.08	17.85	16.22	14.80	13.12	11.09	12.88(2)	11.82(2)
Net Earnings before Taxes	9.20	8.76	9.33	8.49	7.88	7.34	6.35	5.87	N.A.	N.A.
Less: Income Taxes	4.37	4.14	3.71	3.54	3.23	3.20	3.05	2.61	N.A.	N.A.
Net Profit	4.83	4.62	5.62	4.95	4.65	4.14	3.30	3.26	2.75	2.70
Dividends	3.83	3.65	3.43	3.19	3.03	2.71	2.53	2.33	2.15	2.12
Balance	1.00	.97	2.19	1.76	1.62	1.43	.77	.93	.60	.58

(2) Includes unstated income taxes.

Ratios	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Mortgages % Total Assets	79.37	78.32	77.56	78.66	79.59	75.26	74.52	76.68	73.69	72.40
Bonds % Total Assets	12.27	11.84	13.28	11.91	10.67	14.87	16.28	13.20	15.37	15.62
Stocks % Total Assets	4.33	4.74	4.63	4.34	4.42	4.06	3.63	3.64	3.95	4.09
Deposits % Liabilities to Public	26.35	27.15	34.51	32.00	35.71	35.99	35.36	35.69	36.81	36.68
Debentures % Liab. to Public	70.57	70.44	63.55	62.19	61.67	56.22	57.54	57.28	55.56	55.57
Equity % Liabilities to Public	15.42	16.74	18.99	14.94	20.09	15.20	16.32	18.89	19.14	19.84
Average rate earned on:										
- mortgages (3)	6.63	6.55	6.40	6.51	6.11	5.96	5.80	5.63	5.53	5.41
- bonds (3)	4.27	4.12	3.66	3.[illegible]	4.08	3.41	3.00	3.51	3.28	3.20
- stocks (3)	5.72	5.06	4.45	4.91	4.98	4.91	4.90	5.25	5.22	5.60
Revenue % Total Assets	6.53	6.37	6.32	6.10	5.90	5.67	5.49	5.49	5.28	5.11
Expenditures % Revenue	76.26	74.08	69.32	67.77	67.30	66.85	67.39	65.39	N.A.	N.A.
Net Profit % Total Assets	.81	.87	1.17	1.15	1.14	1.06	.93	1.06	.93	.95
Net Profit % Equity	6.10	6.07	7.32	8.82	6.80	8.03	6.63	6.65	5.79	5.74
Dividends % Net Profit	79.30	79.00	61.03	64.44	65.16	65.46	76.67	71.47	78.18	78.52

(3) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960, and is, therefore, not a weighted average return on investment.

Source: Report of the Registrar of Loan and Trust Corporations for the Province of Ontario. The report includes the particulars of the business of each loan company registered and conducting business in Ontario comprised of the following nine companies in 1960, listed in order of size of total assets in $ millions.

1. Canada Permanent Mortgage Corp. 233.39
2. Huron and Erie Mortgage Corp. 152.91
3. Credit Foncier Franco-Canadien 100.25
4. Eastern Canada Savings and Loan Co. 46.17
5. Ontario Loan and Debenture Co. 44.55
6. Lambton Loan and Investment Co. 11.73
7. Royal Trust Company Mortgage Corp. 2.55
8. Commonwealth Mortgage & Savings Corp. .90
9. Family Mortgage Co. .57

EXHIBIT G
Table 6

SELECTED CANADIAN LOAN CORPORATIONS (as at December 31st, 1960)

	Industry (9 Cos.)	Canada Permanent Mtge.	Credit Foncier Franco-Canadien	Eastern Can. Savings & Loan	Huron & Erie Mortgage	Lambton Loan & Investment	Ontario Loan & Debenture
Assets ($ millions)							
Mortgages	470.68	181.08	81.67	41.06	117.45	9.51	36.04
Bonds	72.75	30.79	7.21	3.77	22.31	1.20	7.46
Stocks	25.70	9.98	7.30	.58	7.07	.33	.44
Total Assets	593.01	233.39	100.25	46.17	152.91	11.73	44.55
Liabilities ($ millions)							
Deposits	135.40	64.51	—	6.58	52.32	3.27	8.67
Debentures	362.55	145.86	57.12	34.95	88.18	6.39	29.26
Total Liabilities to Public	513.78	214.62	66.57	42.56	141.05	9.78	38.22
Equity	79.23	18.77	33.68	3.60	11.85	1.95	6.33
Revenue ($ millions)							
Mortgages	31.20	12.16	5.60	2.76	7.42	.61	2.47
Bonds	3.11	1.43	.01	.24	1.08	.0½	.29
Stocks	1.47	.68	.34	.03	.38	.02	.03
Total Revenue	38.75	15.06	7.19	3.06	9.64	.69	2.90
Expenditures	29.55	12.08	4.58	2.44	7.85	.47	2.02
Net Earnings before Taxes	9.20	2.98	2.61	.62	1.79	.22	.88
Income Taxes	4.37	1.37	1.35	.30	.83	.10	.38
Net Profit	4.83	1.61	1.26	.32	.96	.12	.50
Dividends	3.83	1.60	1.06	.19	.57	.11	.30
Ratios							
Mortgages % Total Assets	79.37	77.59	81.47	88.93	76.81	81.07	80.90
Bonds % Total Assets	12.27	13.19	7.19	8.17	14.59	10.23	16.75
Stocks % Total Assets	4.33	4.28	7.28	1.41	6.02	3.47	.99
Deposits % Liabilities to Public	26.35	30.06	—	15.46	37.09	33.44	22.68
Debentures % Liab. to Public	70.57	67.96	85.80	82.12	62.52	65.34	76.56
Equity % Liab. to Public	15.42	8.75	50.59	8.46	8.40	19.94	16.56
Average rate earned on:							
- mortgages (1)	6.63	6.72	6.86	6.72	6.32	6.41	6.85
- bonds (1)	4.27	4.64		6.37	4.84	4.36	3.89
- stocks (1)	5.72	6.81	4.66	5.17	5.37	6.06	6.82
Revenue % Total Assets	6.53	6.45	7.17	6.63	6.30	5.88	6.51
Expenditures % Revenue	76.26	80.21	63.70	79.74	81.43	68.12	69.66
Net Profit % Total Assets	.81	.69	1.26	.69	.63	1.02	1.12
Net Profit % Equity	6.10	8.58	3.74	8.89	8.10	6.15	7.90
Dividends % Net Profit	79.30	99.38	84.13	59.38	59.38	91.67	60.00

(1) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960, and is, therefore, not a weighted average return on investment.

EXHIBIT H

CREDIT UNIONS (1) (as at December 31)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
- Loans (2)	425	397	320	258	226	174	151	129	94	76
- Mortgages (2)	387	341	295	262	236	211	171	155	131	113
- Investments	279	257	238	200	183	163	144	133	120	100
- Cash	166	129	127	108	94	87	71	51	56	51
- Other Assets	42	34	29	24	22	18	15	21	23	19
- Total Assets	1,299	1,158	1,009	852	761	653	552	489	424	359
Liabilities										
- Shares	474	402	341	272	232	194	161	133	102	81
- Deposits	721	658	594	515	468	409	350	320	294	253
- Other Liabilities	27	29	18	18	16	11	15	27	8	7
- Surplus Funds	77	69	56	47	45	39	26	9	20	18
- Total Liabilities	1,299	1,158	1,009	852	761	653	552	489	424	359
Number of Credit Unions	4,667	4,570	4,485	4,349	4,258	4,100	3,920	3,606	3,333	3,121
Number of Members (thousands)	2,544	2,360	2,187	2,060	1,870	1,731	1,561	1,434	1,260	1,138

(1) Includes Caisse Populaires and, Newfoundland Credit Unions from 1951-58.
(2) For 1951-55 the division of total loans between mortgage loans and other loans has been estimated.

Source: Bank of Canada Statistical Summary.

EXHIBIT I

QUEBEC SAVINGS BANKS (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Bank of Canada notes plus deposits with Bank of Canada and Chartered Banks.	25.6	26.4	24.7	26.3	20.3	18.5	19.5	14.7	13.6	16.7
Canadian Securities										
- Government of Canada	38.7	28.2	28.2	38.8	44.9	54.9	64.7	91.6	95.5	89.6
- Provincial	86.7	89.7	102.1	85.6	83.2	80.0	68.0	49.0	48.1	48.6
- Municipal	40.7	46.5	53.3	52.2	56.0	56.7	46.9	37.3	33.1	27.8
- Other	25.2	21.2	18.1	16.8	15.4	16.2	15.6	10.5	8.1	9.2
- Total	191.3	185.6	201.7	193.4	199.5	207.8	195.2	188.4	184.8	175.2
Mortgages and Loans										
- Insured N.H.A. Mortgages	10.4	10.7	10.7	10.1	9.2	5.6	2.7	-	-	-
- Other Mortgages	50.6	47.1	40.0	30.7	20.4	14.1	10.0	6.7	4.4	1.7
- Loans Otherwise Secured	8.0	7.1	6.5	8.8	7.8	5.9	5.0	4.6	4.4	4.3
- Unsecured loans	6.4	6.2	5.6	4.0	3.2	2.3	2.4	3.0	1.7	0.5
- Total	75.4	71.1	62.8	53.6	40.6	27.9	20.1	14.3	10.5	6.5
Other Assets	19.1	14.9	13.7	12.4	12.3	10.9	8.1	8.5	9.2	6.7
Total Assets	311.4	298.0	302.9	285.7	272.7	265.1	242.9	225.9	218.1	205.1
Liabilities										
Secured Advances from										
- Bank of Canada	-	-	-	-	-	-	-	-	-	-
- Chartered Banks	1.6	2.0	4.1	4.7	7.7	5.3	3.0	2.5	1.9	0.8
Deposits										
- Government of Canada	5.6	12.2	6.7	9.9	0.3	0.4	0.3	0.3	-	0.1
- Provincial Government	3.8	2.1	4.1	2.8	0.9	0.1	0.1	0.1	0.1	0.1
- Public	285.3	267.7	274.1	255.1	251.1	246.8	227.4	211.8	205.2	193.3
- Total	294.7	282.0	284.9	267.8	252.3	247.3	227.8	212.2	205.3	193.5
Other Liabilities	1.4	0.7	1.0	0.7	0.5	0.6	0.5	0.3	0.2	0.3
Shareholders Equity	13.7	13.3	12.9	12.5	12.2	11.9	11.6	10.9	10.7	10.5
Total	311.4	298.0	302.9	285.7	272.7	265.1	242.9	225.9	218.1	205.1

Source: Bank of Canada Statistical Summary.

APPENDIX I

RETAILING BONDS & STOCKS AND RISK CAPITAL

I N D E X

RETAILING BONDS & STOCKS

1. Description of the Retail Market

(1) The retail investor, for the purpose of this submission is taken as an individual who invests in securities. We believe that a better understanding of this market can be obtained if we describe retail investors in three categories. The actual limits established here should be understood in approximate terms only, as a general guide. We felt some actual figures would have to be stated in defining the categories, and they should therefore be used with the limitations they obviously possess.

1. The small investor -- an individual with up to approximately $10,000 capital invested in securities.

II. The medium investor -- an individual with roughly $10,000 to $100,000 capital invested in securities.

III. The large investor -- the individual who has $100,000 or more capital invested in securities.

(2) Until World War I, Canadian savings were small in volume and were invested chiefly in real estate and real estate mortgages or left on deposit with banks. The banks used most of their assets to make commercial loans, investing only a small portion in securities. Under circumstances such as these no capital market is likely to exist.

(3) Although the Canadian Bond business started in the 1880's when some of our member firms now engaged

in the underwriting and distributing of securities were founded, almost all Canadian financing was done in Great Britain until 1914. English bond houses dominated the market and Canadian dealers in most cases acted merely as agents. After receiving the advice of a Canadian dealer, the English bond firm would negotiate directly with the borrower and underwrite the loan, assuming all liability.

(4) Throughout this period the Canadian dealers developed their retail business, confining their activities largely to government and municipal bonds. Methods of buying were rather elementary -- the Dealer frequently combed local newspapers for notices of municipalities and then contacted the local authorities with a view to purchasing the entire issue for retail sale. With the tremendous expansion in business which came in 1900 - 1913 period, Canadian bond houses were able to extend their operations to include a few issues of companies engaged in public utility operation, manufacturing and transportation.

(5) Bond sales had up to the First World War (1914 - 1918) been confined to financial institutions and to wealthy individuals. However, the great increase in wealth in Canada prior to and during World War I made possible the success of the first Victory Loans which require a large number of small purchases. Victory Loan campaigns were organized to make the population "bond conscious" and to persuade the people to loan their savings to the nation. These campaigns, aided by the high interest rates, 5 per cent and 5½ per

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(5) Bond sales had up to the First World War (1914 - 1918) been confined to financial institutions and to wealthy individuals. However, the great increase in wealth in Canada prior to and during World War I made possible the success of the first Victory Loans which require a large number of small purchases. Victory Loan campaigns were organized to make the population "bond conscious" and to persuade the people to loan their savings to the nation. These campaigns, aided by the high interest rates, 5 per cent and 5½ per

cent, brought remarkable success.

(6) In 1915, 24,862 persons subscribed for $78,729,000 of the first domestic War Loan issue. In 1918, over one million persons subscribed over $660,000,000 to the Victory Loan of that year. The campaigns were organized at the Government's request, by the newly-formed "Bond Dealers' Association of Canada".

(7) During the period 1920-1930, almost $6 billion was invested in capital goods, but, contrary to earlier periods of expansion, the amount of foreign capital which came in was much smaller. Less than $1 billion of the $6 billion came from the United States. The investment boom of the twenties was very largely financed out of Canadian savings. As a result Canadian financial houses benefitted greatly by the opportunities which presented themselves during this period.

(8) As in World War I, so in World War II, vast sums of money were raised internally by the Dominion Government through the organized sale of Victory Bonds. Almost the entire amount of Canada's war financing was carried out through domestic operations. In eleven war loan operations the Dominion Government borrowed some $12,200 million from its citizens.

(9) A National War Finance Committee, almost wholly composed of investment dealers, was formed with headquarters in Ottawa and offices in each province. This committee acted as the coordinating body for the efforts of all financial firms in Canada and was the driving force behind the raising of funds for the Government through the sale of Victory Loan Bonds and

War Savings Certificates.

(10) The wide acceptance of Victory Bonds stemmed from the committee's efforts in educating a large selling force of qualified representatives. The concept of a payroll savings plan was introduced to many employers and its continued use today is evidence of its value.

(11) The Victory Loan campaigns of World War II were responsible for hundreds of thousands of Canadians owning, for the first time, an investment security. Today, there are over two million individual Canadians who own Government of Canada bonds. There is no doubt that these securities, held by such a large percentage of the citizens of the country, are a stabilizing and a supporting factor in the period of postwar readjustment through which we are still passing. The habit of thrift which was encouraged during War Loan years and which is renewed each year in the Canada Savings Bond campaigns, has developed many new investors and provides the basis on which a greater investment business can be built in the years ahead.

The Understanding which the Retail Investor has of Securities Markets

(12) THE SMALL INVESTOR will normally not have a very good knowledge of securities markets. It has been found that he will often have his money invested in either of two extremes, i.e. exceedingly conservative, where capital will be entirely in fixed income, high grade bonds, or extremely speculative, with all funds invested in penny gambling stocks. Of course, the size of his holdings severly restricts the degree of

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diversification which is possible and in some cases in recent years, the small investor has turned to mutual funds, not necessarily of his own initiative. Very rarely will the small investor be found who owns one or two good investment grade stocks. The small investor depends almost entirely upon his investment dealer, stock broker or bank manager for guidance with his investments, and the investment dealer actually goes out and cultivates this business and does extensive work in guiding and educating the small investor.

(13) <u>THE MEDIUM INVESTOR</u> quite often has a growing account, being an advancing professional or business man whose income is such that substantial yearly savings are possible. Where this is the case, he will often be relatively well informed, though too busy to enter very fully into a study of investments, or to follow the regular progress of his securities. He too, will rely heavily upon his investment dealer or stock broker and will follow his guidance in most matters.

(14) The medium investor could also be someone dependent upon this capital as a supplementary or even sole source of income. This may be a retired, or semi-retired person, a widow or dependent child who has inherited the capital. Generally speaking, this medium investor will not be too sophisticated or knowledgeable in investment matters, and will tend to follow the guidance of an investment dealer or stock broker. Much of the educational effort done by individual dealers and the Investment Dealers' Association

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is aimed at this market.

(15) THE LARGE INVESTOR is quite different from the small and medium investor. He will normally be quite well informed on securities and markets, will follow details of prices and know what is going on from day to day. He will read financial journals and periodicals, he may subscribe to one or more investment counsel services and will likely do business with more than one investment dealer or stock broker. This is a more competitive market for the investment dealer, but it is also one where the educational effort does not need to be so great and where the costs of doing business relative to the returns are less.

The Variety of Securities Sold in the Retail Market

(16) The small investor is a market for bonds of all types. In the Province of Quebec, and to some extent in the Maritimes, the small investor is a good market for municipal bonds, but this does not hold true to the same extent in the other provinces. In practice, in the past, the small investor has not constituted a good source of capital for new sound enterprises, though many have gone to outright speculation. There is no reason why this should be so, but it does show that a large job of education is still required, which, of course, immensely increases the costs of doing business.

(17) The medium investor also is a good market for all types of bonds, for good quality common stocks and for serious new ventures. Quite often the medium investor is in a high tax bracket, and is therefore interested in capital appreciation with income a

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secondary feature.

(18) The large investor provides a good market for all types of securities from short term Government of Canada bonds to common stock in a risk venture.

2. Servicing the Retail Market

The Investment Dealers

(19) In another section of this brief, it is shown that a large percentage of the investment dealers in Canada are in the retail field.

(20) There are as well other financial intermediaries in this field -- banks and stock brokers sell securities to the retail market, and some mutual funds have their own sales forces. The banks do not send salesmen into the field as investment dealers do, nor do stock brokers to any large extent. Almost exclusively it is investment dealers who have salesmen travelling and covering territories and carrying a broad variety of securities.

Organization Required to Service Retail Accounts

(21) In order to service retail accounts, the investment dealer must first have the knowledge and resources to select and buy the securities which are to be offered to his clients. He then must have a system of distribution -- a sales force with enough clients to purchase the merchandise he has to offer.

(22) Developing a marketing organization is a major task for an investment dealer. To competently service retail accounts investment dealers must have

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salesmen qualified in the sense that they must be familiar with investments, know how to assess securities and, at the same time, be able to convey this to the ordinary individual. This means the investment dealer must have facilities to train salesmen, and have sufficient resources to carry salesmen until they become productive. In turn, the salesman must develop a clientele, and cover a sufficient number of investors so that a wide variety of securities can be sold. He must have enough customers in each category.

(23) The investment dealers must also have an analytical or research department to supply salesmen with information and guidance. The size of this department will depend on the size of the firm and the number of salesmen in the field. Many refinements to research, such as portfolio supervision, have been added in recent years and the competition increasingly demands this type of service.

(24) For investment dealers engaged in underwriting, an underwriting department is required or such work may be the chief function of the senior personnel.

(25) An accounting department and a trading department must be maintained, and the latter particularly requires well trained personnel.

(26) The investment dealer must have a communication system which puts his head office in touch with out of town salesmen and branches. Larger dealers generally use direct wires and all dealers make extensive use of long distance telephone. The business

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necessitates rapid communication.

(27) This organization will vary with size, but in general it must be said the investment dealer requires sufficient facilities to buy and sell securities, to offer these to his customers, and to provide those customers with sufficient information and guidance on their investments.

(28) It is quite apparent from the foregoing section that the costs of doing retail business are high.

The Supply of Information

(29) A large percentage of the cost of the Investment Dealers' Association goes to service the retail investor, to educate him and to provide him with instructive information. All dealers participate in these association endeavours to educate the general public in twoways. First, a substantial portion of the regular fees go to educational work, and secondly, investment dealers lend personnel who donate their time freely to association endeavours.

(30) Investment dealers must, on an independent basis, make available a broad variety of informative material to the public. This could take the form of a monthly letter discussing general conditions or specific securities, it could be a weekly comment, or a review of a company or a special write-up on a new underwriting.

(31) To prepare this material, investment dealers have research departments which may vary in size from one man for a small or local dealer to possibly a dozen people for a large national dealer. The information

necessitates rapid communication.

(27) This organization will vary with size, but in general it must be said the investment dealer requires sufficient facilities to buy and sell securities, to offer these to his customers, and to provide those customers with sufficient information and guidance on their investments.

(28) It is quite apparent from the foregoing section that the costs of doing retail business are high.

The Supply of Information

(29) A large percentage of the cost of the Investment Dealers' Association goes to service the retail investor, to educate him and to provide him with instructive information. All dealers participate in these association endeavours to educate the general public in twoways. First, a substantial portion of the regular fees go to educational work, and secondly, investment dealers lend personnel who donate their time freely to association committees.

(30) Investment dealers must, on an independent basis, make available a broad variety of informative material to the public. This could take the form of a monthly letter discussing general conditions or specific securities, it could be a weekly comment, or a review of a company or a special write-up on a new underwriting.

(31) To prepare this material, investment dealers have research departments which may vary in size from one man for a small or local dealer to possibly a dozen people for a large national dealer. The information

itself may vary from a brief comment for general distribution to a 30 or 40 page study for select distribution.

(32) Investment dealers are continually attempting to interest new investors.

(33) Possibly the greatest number of new investors come to an investment dealer from referrals by his existing clientele. In addition, new investors are attracted by advertising, in which some monthly or other type of informative material might be offered. When investors respond, they are followed up by the firm's salesmen.

(34A) New investors can also be approached directly when Government Bonds are being offered, and this is widely done on Canada Savings Bond campaigns. It should be pointed out that investment dealers go out and aggressively sell Canada Savings Bonds to established and new accounts. They do not just accept unsolicited orders. This is considered to be a valuable service since it puts Canada Savings Bonds into the hands of many people who would not otherwise own them, and provides a broader and a stronger distribution of these securities.

(34B) It should be noted that investment dealers are prohibited by law from directly approaching new accounts at home for other than Government Bonds, and this does have a restricting influence on the development of new accounts.

<u>The Training of Retail Salesmen</u>

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programs. In most cases, this necessitates the prospective salesman spending time in each of the different operating departments so that he can become thoroughly familiar with the total operation. During this time, he attends sales meetings and is expected to familiarize himself with investments and securities markets. He is often required to complete one or both of the two courses in the "principles and practices of investment finance in Canda" offered by the Investment Dealers' Association.

(36) Training is, of course, a continuous process of education. The salesman should be able to rely upon his firm for basic information and opinions on conditions in general and securities in particular.

Protecting Investors' Capital

(37) Investment dealers continue to take an interest in an enterprise after the securities of that enterprise have been distributed by them to investors. A representative will often sit on the Board of Directors and even on the management committee and financial statements and reports are obtained and studied regularly. If a situation develops where investors' capital may be in danger, investment dealers will devote a considerable amount of time and, sometimes, capital, to protect their clients' capital and to attempt to restore the enterprise to a profitable operation.

RISK CAPITAL

(38) It is quite apparent and an accepted fact that risk capital is essential to the future

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Definition

(39) Risk capital, for the purposes of this submission, is taken to mean capital which is used for the development of new ventures, which ventures might be in primary or secondary industry. All types and variations of securities are used to raise risk capital in the retail markets. Bonds and debentures, convertible or with warrants attached, preferred stocks and common stocks are all employed, singly and in units.

Sources of Risk Capital

(40) The risk capital required in Canada has been and will continue to come from corporations, from institutions, from foreign investors and from small groups of large investors and from the general public. It is with this latter group that this submission is concerned.

The Public's Record and Attitude

(41) For purposes of this presentation, we should like to make a distinction between two different types of risk capital.

(a) That capital which is placed for long term investment in ventures, intelligently and seriously conceived and backed by reputable entrepreneurs. This is primarily the business of investment dealers.

(b) That capital which is invested for large, immediate profits, with little or no concern for the ultimate outcome

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of the enterprise. The degree of risk in this case is extremely high and the chance of ultimate success is often doubtful. Such capital is quite often associated with mining and oil development, and in some cases, it is difficult to determine the integrity of the scheme.

(42) It is our considered opinion that interest has been developing in that type of capital described under (a), but too many retail investors who do take an interest in (a) will often exploit an early opportunity for small short term capital gain and ignore the ultimate benefits. Thus, the equity in many long term ventures has shifted gradually from the public to institutional and foreign investors, who are more sophisticated and prepared to wait for long term development.

(43) The public will invest and hold the equity of established and proven enterprises for long periods of time, as witness the large retail interest in the common stock of leading Canadian companies, but investing in new unproven enterprise seems to be regarded more as a speculation than a serious and eventually profitable business. The lack of interest in the ultimate development of the actual enterprise itself takes second place to the interest in the short term action of the common stock. Possibly only bitter experience with (b) will eventually change this attitude. The investment dealer, through a widespread educational effort is doing a great deal to help, but

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(44) This submission is concerned only with risk capital raised by investment dealers.

(45) Ventures requiring capital may be brought to an investment dealer by a promoter or entrepreneur, who has either previously done business with him, or who has been recommended by someone who has. The investment dealer will study all the facts and thoroughly examine the situation.

(46) Once the investment dealer is satisfied that an enterprise is feasible, he will discuss and suggest what form the financing should take. This latter consideration is affected by many things, including the current markets. Here, of course, government policy is most important in setting the proper environment, and this is true whether fixed income, senior security financing or equity financing is involved.

(47) After this has been done, the securities must be sold. In the retailing operation, the investment dealer will inform his salesman of the details of the proposed issue of securities. How this communication of information actually occurs will vary, but normally the dealer will hold a sales meeting into which he will bring all his salesmen. At this meeting, he will have company representatives to answer questions and fully explain the particular issue. A field trip to the Company's plant or proposed plant or

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RETAILING BONDS AND STOCKS, AND RISK CAPITAL, CONCLUSIONS AND RECOMMENDATION FOR THE I.D.A. BRIEF

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(b) Government Influence on Stability. Government policies have an immense effect on retail investors. Investment dealers who sell and trade Government and corporation securities and raise risk capital must do so under stable market conditions. Therefore, when disturbing factors arise, Government leaders should do everything possible to clarify the situation and restore stability.

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APPENDIX J

STOCK BUSINESS

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TABLES

STOCK BUSINESS

1. INTRODUCTION

In considering the operations of investment dealers, stock business obviously bulks very large and may indeed lay claim to pride of place. In the following pages, an effort is made to describe the nature of this business. It is first intended to examine briefly the various markets where Canadian securities are traded, and this will include a discussion of secondary distributions and the over-the-counter market. Most of the analysis will be concerned with the questions of the supply of and the demand for Canadian stocks. In this connection, some estimates will be made of net annual flows of funds from various sources into the Canadian stock market as well as of the existing importance of selected investors -- both individual and institutional -- in Canadian equity ownership. In addition, the part played by investment dealers and companies in helping to broaden stock ownership in Canada will be discussed briefly. The section will conclude with a number of recommendations.

2. THE STOCK EXCHANGES IN CANADA.

There are at present six exchanges in Canada. The relative size of their operations is indicated in the following table, which covers trading in 1960. As a basis of comparison, in the same year the number and value of shares traded on the New York Stock Exchange amounted to 987 million shares and $38.0 billion respectively, and on the American Stock Exchange to 32 million shares and $4.2 billion.

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TABLE I

Stock Exchange Transactions in 1960

	Industrial Shares (a)	Mines and Oils Shares	Total Shares	Clearing Values
	- - - -thousand shares	- -	- -	-($ thousands)
Toronto	43,758	425,933	469,692	$1,223,330
Montreal(b)	19,298	58,186	77,485	671,993
Vancouver	2,237	19,026	21,263	40,468
Calgary	196	9,812	10,009	2,760
Winnipeg	111	377	488	1,615

(a) Shares of industrials, public utilities, banks, etc.

(b) Montreal Stock Exchange and Canadian Stock Exchange combined.

Source: Toronto Stock Exchange

3. At the end of 1961 there were 1,117 stocks listed on the Toronto Stock Exchange with a quoted market value of $61 billion, and 832 on the Montreal and Canadian Exchanges with a market value of $59 billion. If account is taken of the substantial amount of duplication arising out of interlistings, the quoted market value of stocks on the Montreal and Toronto exchanges may be estimated at under $62 billion, covering some 1,250 stocks. Of these, 21 with a market value of $31 3/4 billion consisted of foreign firms, mainly a few large U.S. companies, whose stocks are listed in Canada as well as in the United States. Of the remainder, 168 with a market value of about $1 billion were preferred stocks; this left listings having a value of $29 billion made up of Canadian common, "A" and "B" stocks.

4. A number of Canadian shares are listed

abroad, mainly in the United States. At the end of 1961, there were 11 Canadian companies listed on the New York Stock Exchange and 94 on the American Stock Exchange. Other centers where Canadian stocks are traded include London, Brussels and Paris.

5. As a measure of trading activity, Toronto clearing values in 1961 represented 4.1 per cent of the total quoted market value of the list at the end of the year. If the foreign stocks are excluded, the proportion is raised to 8.6 per cent. A further refinement is the removal of that section of the list which is in effect untradeable; this includes stocks that are owned on a permanent basis, notably inter-company holdings. The Bank of Nova Scotia, in its monthly review of October, 1960, estimates that 30 per cent of Canadian securities fall into this class, which would reduce the market value at the close of 1961 of potentially active stocks on the Toronto list to $20.5 billion and lift the measure of trading activity (clearing values of that year as a proportion of the adjusted total) to 12.3 per cent. It should be noted that 1961 was an active period in stock trading; in 1960, on the other hand, which was slow, clearing values were only half as large.

Secondary Distributions

6. In any discussion of the operations of Canadian stock markets, the secondary method of distribution must be mentioned. Usually, the offering is of a block of stock which is too big to be readily assimilated in the day-to-day market on the stock

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Secondary Distribution

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exchanges. In Canada, the total value of the stock offered in any one distribution might range between $250,000 to perhaps $2 million or $3 million. These "secondaries", developed several years ago, have been used more and more frequently in the past two or three years as the most efficient method of distributing stocks on a wide basis.

7. The vendor of the stock, by negotiation with one dealer, will agree to terms of offering, such as pricing and the commission to be paid to the underwriting or distributing group. The originating dealer usually invites other dealers to accept an underwriting position in the group. This group accepts firm stock at the offering prices, less a commission previously arranged.

8. The price at which the offering will be made usually bears a very close relationship to the quoted market on the Stock Exchange for the stock. Generally speaking, the offering price is on the bid side of the market or, in some cases, slightly below the bid side. Various factors must be considered when pricing the offering, such as general market conditions, outlook for the company whose stock is being offered, and the popularity of the stock being offered.

9. The commission paid on the offering, as it has developed in the Canadian market, usually amounts to double the minimum Stock Exchange commission on a stock selling at the offering price and, in some cases, there may be an additional small commission which might be considered a finder's fee. It might be noted that

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Stock Exchange Commissions in Canada

10. Since the late 1930's there have been two revisions of the scale of commissions charged by brokers for effecting transactions for their clients. The first realignment in 1945 involved almost entirely an upward revision of charges in all classes. The second was a combination of upward revisions and reclassifications which removed certain anomalies in the fees charged to clients. In themselves, the upward adjustments were not substantial in relation to the volume of money involved in many transactions. It should be noted that, in the post-war period, demands for added services, communications and servicing of transactions have required a considerable increase in operating expenditures by brokers. A further revision of these brokerage charges may have to be made so as to reflect more fully the dollar value of the transaction and the true cost of effecting the smaller transactions. In other words, commissions may have to be re-examined in the light of operating expenditures on services, the maintenance of which is necessary if the full interests of clients are to be served. This would be done only after a thorough and exhaustive review of the increased capital cost of doing business and of the relationship of commissions to the dollar value of the transaction.

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The Over-the-Counter Market

11. The Canadian over-the-counter market covers virtually all transactions of the following securities: Government, Provincial and Municipal bonds and corporate debentures; in addition, many stock issues, which for one reason or another are not listed on an exchange, are traded on the market, as well as most mutual fund shares. Among the quality stocks involved, mention may be made of those of a number of insurance companies and trust companies. Transactions also take place in several European securities, particularly of British origin. The over-the-counter market is extensively used by investment dealers, providing an initial market for new issue securities. Most new industrial issues, being offered for the first time to the Canadian public, initially trade over the counter prior to becoming listed on recognized Canadian stock exchanges. Rights offerings to shareholders in a good many cases trade over the counter during a limited period until the right expires.

12. In the natural resource field, the over-the-counter market facilitates trading in a wide variety of low-priced speculative securities. These stocks usually represent small exploration attempts to develop natural resources in Canada. Usually, where success is achieved in the development of a natural resource, the stock in question will qualify for listing on one of the stock exchanges in the country; the vast majority of these speculative vehicles, however, remains unlisted and very often dormant until revived by

circumstances within their area of activity.

13. The over-the-counter market is vast and complex and not located in any given meeting place. From coast to coast, traders in investment and brokerage firms are constantly in touch with each other through private telegraph wires, telephones and other communication facilities at their disposal. In the over-the-counter market, the dealer acts either as principal or as agent. Acting as principal, he buys or sells securities net without any commission charge; in acting as an agent he usually adheres to commissions prescribed by the Montreal and Toronto Stock Exchanges. Very often, the over-the-counter dealer is obliged to take inventory positions in securities which he may be trading. He therefore risks his own capital in the maintenance of various positions in anticipation of a future demand for the security in question.

14. Because so many securities of varying characteristics are traded over the counter by large, medium-sized and small investment firms, it is impossible to determine the gross dollar turn-over for any given period of time. At certain times, particularly during the creation of brand new industries, such an uranium, oil and gas and the related pipelines, activity in the over-the-counter markets increases sharply; the same is true during periods of traditional natural resource development. At other times, trading in over-the-counter securities shrinks, reflecting movements only in a limited number of Canadian securities. As compared with the American market, Canada's over-the-counter market

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in stocks is extremely small. In the United States, there are about 5,000 unlisted issues quoted daily in American papers as opposed to only 1,600 stocks listed on the New York Stock Exchange. In Canada, the reverse would be the case, excluding penny mining shares, in that there are far more shares of Canadian companies listed on recognized stock exchanges than there are traded in the Canadian over-the-counter market.

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15. THE SUPPLY OF STOCKS

The discussion now turns on the supply of shares, which constitutes one of the most important topics falling within the broad subject of stock business. While frequent mention is made of this supply, it is hard to analyze in terms of actual quantities. At any given moment in time, the supply may be expressed as the value of stocks on the Canadian exchanges, adjustments having been made for those listed on more than one exchange, for foreign stocks listed on Canadian exchanges and perhaps also for that proportion which is so unlikely to be traded that it cannot be regarded as forming part of any potential offering. A second measure of supply is the total of new stocks, net of redemptions, issued over a period of years. In Table II, this information is given for the period since 1952.

16. The significance of these figures is discussed in detail in the section relating to Corporation Finance. Suffice it to say here that: (a) there has been a steady post-war rise in the proportion

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15. THE SUPPLY OF STOCKS

The discussion now turns on the supply of shares, which constitutes one of the most important topics falling within the broad subject of stock business. While frequent mention is made of this supply, it is hard to analyse in terms of actual quantities. At any given moment in time, the supply may be expressed as the value of stocks on the Canadian exchanges, adjustments having been made for those listed on more than one exchange, for foreign stocks listed on Canadian exchanges and perhaps also for that proportion which is so unlikely to be traded that it cannot be regarded as forming part of any potential offering. A second measure of supply is the total of new stocks, net of redemptions, issued over a period of years. In Table II, this information is given for the period since 1952.

16. The significance of these figures is discussed in detail in the section relating to Corporation Finance. Suffice it to say here that: (a) there has been a steady post-war rise in the proportion

TABLE II

Net New Security Issues

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961 *	Total 1952-1961	%
	......	......	......	......	......	million dollars	......	......	......	......	......	
Common Stocks	$ 223	185	147	367	514	426	287	331	182	242	$ 2,904	36
Preferred Stocks	16	51	25	95	175	89	25	73	52	44	645	8
Total Equity	239	236	172	462	689	515	312	404	234	286	3,549	44
Corporate Bonds	373	375	445	324	794	954	654	108	290	275	4,592	56
Total Financing	$ 612	611	617	786	1,483	1,469	966	512	524	561	$ 8,141	100%

* Does not include the retirement of $111 million of B.C. Electric Co. held by the parent company, but does include partial distribution of $86 million to shareholders of B.C. Power.

Source: Bank of Canada Statistical Summary, December, 1961; Financial Supplement, 1958.

of business capital expenditures financed internally; (b) in the period since 1952, the dollar amount of business external financing rose to a peak in 1956-1957 and has since subsided to less than half its record levels; (c) within this total, somewhat more than two-fifths has been accounted for by equity financing.

17. Among the many factors affecting the supply of Canadian stocks, the following are among the more important:

(a) Perhaps the most obvious, is the nature of Canada's economic development. The emphasis on the exploitation of Canada's natural resources is most strikingly reflected on the board of the Toronto Stock Exchange where "penny" mining shares abound; close to half of the stocks listed are in fact priced at less than $5.00. The absence of "space" stocks, the limited number of electronics, chemical and drug stocks, etc., again reflect the character of industrial growth in this country.

(b) The great importance of foreign ownership in a number of Canadian industries has resulted either in the presence in Canada of wholly-owned subsidiaries in the operations of which the public cannot acquire a direct interest, or in the effective withdrawal from the market of the majority of a company's stock; Ford Motor Company of Canada, 75 per cent owned by Ford of U.S., is an example of the latter process. The subject is discussed at greater length in a separate section.

(c) The extent of public ownership is a third general determinant of the availability of Canadian

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equities; its effects are most obvious in transportation and utilities; the expropriation of B.C. Electric is the most recent case in point.

(d) The mutualization of insurance companies provides another example of the withdrawal of stocks from the market. In the three years 1958-1960, such purchases averaged $52 million annually.

(e) Among considerations internal to corporations that affect the supply, mention should be made of the incentive to debt financing provided by the fact that interest costs are pre-taxed; indeed, every time the corporate tax rate is increased, this incentive strengthens.

(f) Also militating against equity financing is the prospect of further inflation; clearly the possibility of borrowing money having a certain purchasing power and eventually repaying it in currency with a reduced purchasing power acts as a stimulus to debt financing.

18. There are, at the same time, a number of expansionary influences on the supply of stocks. The absence of a capital gains tax, by enabling profits to be realized with no penalty to the stockholder, provides a real stimulus to trading. The 1954 revision of the Bank Act, which permitted the chartered banks to exclude certain classes of their shareholders from share offerings, enabled them to escape the disclosure requirements of the U.S. Securities Exchange Commission, and has greatly stimulated the issue of bank shares through rights offerings. As a general comment, because of the

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existence of S.E.C. regulations, rights issues of Canadian companies are sometimes not offered to U.S. residents, and this has the result of adding to the supply of stocks on the Canadian markets. Perhaps, though, the most important reasons for the steadiness of the flow of new equity issues in the post-war period are: a) some companies do not have the financial standing and/or lack the type of assets that would permit financing at a reasonable cost through the sale of long term debt; b) other companies that do not suffer from these limitations nevertheless make stock issues because of the need to build up their equity base; understandably, this is particularly true where retained earnings are relatively unimportant and is characteristic of certain kinds of utilities, as for instance pipe lines and Bell Telephone.

19. From these few comments, it is apparent that among the forces affecting the supply of Canadian equities, a significant number have a restrictive influence.

20. STOCK OWNERSHIP AND SOURCES OF DEMAND FOR STOCKS

The incidence of stock holdings among individual Canadians and the importance of financial institutions in Canada in the ownership of stocks are subjects which are of immense interest but on which, as a general rule, only limited statistical information is available.

Individual Investors

21. Looking first of all at the position of individuals, some broad comments can be made on the

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TABLE III

Percentage of Non-Farm Families and Unattached Individuals Owning Stocks within Selected Income Groups

	Income Groups					
	Under $2,000	$2,000-$4,999	$5,000 $6,999	$7,000 $9,999	$10,000 and over	All Families and Unattached Individuals
1959 Spring	3.1%	5.1%	12.5%	20.9%	43.7%	9.2%
1956 March	4.0	5.1	13.7	28.1	50.6	8.9

Note: The total of families and unattached individuals was 4,460,000 in 1958 and 4,051,000 in 1955; the family is defined as a group of individuals sharing a common dwelling unit and related by blood, marriage or adoption. Unattached individuals are persons living by themselves or rooming in a household where they are not related to other household members.

Source: D.B.S. Incomes, Liquid Assets and Indebtedness of Non-Farm Families in Canada 1955, 1958.

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1959 Spring	3.1%	5.1%	12.5%	20.9%	43.7%	9.2%
1956 March	4.0	5.1	13.7	28.1	50.6	[illegible]

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incidence of equity ownership among various income groups. In Table III the findings of two surveys covering non-farm families and unattached individuals in Canada are presented. It deserves to be pointed out that, under the wording of the questionnaire, both publicly traded common and preferred stocks and those traded over the counter were included; the survey was not limited to Canadian equities; with respect to the treatment given to mutual funds, while the wording was somewhat ambiguous, it may be assumed that most mutual fund shareholders will have regarded themselves as stockholders in their replies.

22. From Table III, it appears that in the spring of 1959 a little over 9 per cent of Canadian families and unattached individuals owned stocks, an increase of 50,000 from three years previously. Within the various income groups, it is not surprising to find by far the greatest incidence of ownership among the higher brackets. It should be emphasized that these figures must be treated with caution (particularly those for 1956 which are based on a considerably smaller sample than was the case in 1959); nevertheless, it is of some interest to note that the overall percentages are not very different from those obtained in the United States: a U.S. survey (Federal Reserve Bulletin, June, 1955) revealed that 8 per cent of U.S. family units were stockholders.

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out that they refer only to taxable persons, that is to say to persons whose taxable income exceeded their exemptions; (that this should not be too serious a limitation, however, is suggested by the fact that in 1959 dividend income reported in non-taxable returns amounted to only $10,383,000, as against a total of $296,218,000 in taxable returns). As in Table III, the findings relate to both preferred and common stocks; unlike the earlier table, however, the information is limited to holdings of stocks of taxable Canadian corporations, since it is only on these that the credit may be claimed. As to the reliability of these taxation figures, the incentive to accurate reporting provided by the dividend tax credit is obviously important; it has been estimated that the amount of dividends reported on the individual income tax returns represents more than 90 per cent of actual dividend receipts.

24. Not surprisingly, the incidence of stock ownership indicated in Table IV (those claiming a dividend tax credit as a percent of total taxable persons) is lower throughout the various income groups than in Table III, where no distinction is drawn between holdings of dividend-paying and non-dividend paying stocks. Perhaps the most interesting feature of the table is the evidence it provides of the concentration of stock ownership; 55,000 individuals, representing little more than $1\frac{1}{4}$ per cent of all taxable persons in Canada, accounted for over 60 per cent of dividend income reported in all taxable returns.

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TABLE IV

Dividend Income in 1959

	Under $2,000	$2,000-$4,999	$5,000 $6,999	$7,000 $9,000	$10,000 and over	All Income Groups
Number of Taxable Persons	662,240	2,655,522	593,143	204,128	127,457	4,242,490
No claiming Dividend Tax credit	15,725	105,397	50,115	37,344	55,022	263,603
As % of No. of Taxable persons	2.4%	4.0%	8.4%	18.3%	43.2%	6.2%
Total Dividends Received ($000)	$ 7,044	$ 49,140	$27,548	$ 31,998	$180,488	$296,218
As % of Total for all Income Groups	2.4%	16.6%	9.3%	10.8%	60.9%	100%

Source: Department of National Revenue

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Total Dividends Received ($000)	$ 7,044	$ 49,140	$27,573	$ 31,998	$180,458	$296,218
As % of Total for all Income Groups	2.4%	16.6%	9.3%	10.8%	60.9%	100%

Source: Department of National Revenue

value of individuals' stock holdings. Statistics on the net flows of personal savings into the stock market are also conspicuously absent; it is nonetheless true that Canadians enjoy a number of incentives to stock ownership, which residents of other countries, notably the United States,lack. The absence of a capital gains tax, mentioned in the section dealing with the supply of stocks, removes a deterrent to equity ownership which exists in countries where this tax is present. The elimination in the budget of December, 1960, of the 4 per cent surtax paid by persons with investment income of $2,500 or more -- so long as the income is from Canadian sources -- provided an incentive to Canadian stock ownership. Finally, this form of tax encouragement exists in what is perhaps its most effective form in the 20 per cent dividend tax credit which is allowed Canadian residents on dividend income from Canadian corporations; incentives of a somewhat similar nature -- but less powerful -- exist also in the depletion allowances granted on dividends of oil, gas or mining companies.

Institutional Investors

26. The distinction that is commonly drawn between individual investors and institutional investors is, it must be admmtted, somewhat forced. Considering the question of the incidence of share ownership, for instance, there is a danger of double counting; an individual owning shares in a mutual fund or having funds administered by a trust company, a proportion of which is invested in equities, will regard himself as a

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stockholder and will have been covered in the questionnaire discussed in the preceding section. The fact remains, however, that financial intermediaries, by their very nature, constitute major repositories of funds, which sometimes lend themselves to analysis; it is important to be aware of the different investment policies of these intermediaries and of the changes that may be taking place in such policies; indeed, one of the most interesting post-war developments has been the growth in the so-called contractual forms of personal saving, which is best illustrated in the rapid expansion of life insurance companies and pension funds.

27. The information available on institutions varies widely from being extensive in the case of pension funds to largely non-existent in that of administered trust company funds. For the purposes of this submission, there are two questions to which it seems important to try to find answers: (a) what is the net annual flow of fresh money into Canadian common stocks from the various instituions, and (b) what is the importance of existing holdings in relation to the Canadian market. To answer the first question, it would be necessary to have book value figures of Canadian common stock holdings over a period of years, the difference from year to year indicating the net participation in the Canadian equity market of each type of instituion. For a second question, the market values of such investments are needed. In the following discussion, it will become apparent that in many cases both sets of figures are not available and in some cases,

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TABLE V

Changes in Stock Holdings (Book Value)

	1955	1956	1957	1958	1959	1960	1955-1959
				millions dollars			
New Stock Issues	462	689	515	312	404	234	2,382
Changes in stock holdings of -							
Life Insurance Companies	14	8	1	21	11	5	55
Fire & Casualty Companies	9	8	5	8	7	N.A.	37
Trust Companies	1	6	3	1	4	2	15
Mortgage Loan Companies	7	5	1	9	3	3	25
Pension Funds	N.A.	N.A.	21	43	53	55	117
Investment Companies	44	51	35	24	77	47	231
NRO Funds	68	70	74	14	-10	-30	216
Other foreign portfolio investments	140	183	99	101	150	96	673
Total	283	331	239	221	295	-	1,369
As % of New Stock Issues	61.2%	48.0%	46.4%	71.2%	73.0%	-	57.5%

Sources: Bank of Nova Scotia Monthly Review, October 1960; Investment company reports; some figures are partially estimated.

that are published, are subject to serious limitations.

28. In Table V changes in the book value holdings of selected institutions as well as in foreign portfolio investments are related to net new stock issues. Some of these findings are examined in greater detail in the following pages. As a general comment, the figures should be used with extreme caution.

29. Life Insurance Companies

In Table VI, a breakdown of the assets of life insurance companies at book values is presented.

30. One of the most striking features of this table is the small proportion of assets invested in common stocks; indeed, in the post-war period, life insurance company holdings as a proportion of total assets have never approached the 15 per cent statutory limit established in 1932.

31. One difficulty in using book values to determine the net flows of investment funds into Canadian common stocks is the practice of insurance companies of writing down such figures; the incentive is provided by the fact that they are under statutory obligation to value their assets as of some particular period and show a state of complete solvency. It is therefore not necessarily true, for instance, that in 1960 the net inflow for equity investment was $5 million ($176 million less $171 million). In this connection, the monthly statistics covering the investment transactions of the 12 major life companies, published by the Bank of Canada, are of limited help, since they

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TABLE VI

Life Insurance Company Assets

As at December 31,	1954 $ million	1954 %	1959 $ million	1959 %	1960 $ million	1960 %
Canadian Securities	3,045	58.2	3,740	50.0	3,980	49.7
Bonds	2,929	56.0	3,510	47.0	3,755	46.9
Preferred & common	116	2.2	171	2.3	176	2.2
Own Stock remutualization	-	-	59	0.7	49	0.6
Foreign Securities	169	3.2	186	2.5	191	2.4
Bonds	111	2.1	116	1.6	121	1.5
Preferred & common	58	1.1	70	0.9	70	0.9
Mortgages	1,519	29.1	2,787	37.3	3,011	37.6
Other	493	9.5	761	10.2	825	10.3
Total Assets:	5,226	100%	7,474	100%	8,007	100%

NOTE: Life branch assets of all companies registered under the Federal Insurance Acts, comprising all assets physically held in Canada by Canadian companies and British and foreign companies; Canadian dollar assets held outside Canada are excluded.

Source: Bank of CanadaStatistical Summary, August 1961

TABLE VI

Life Insurance Company Assets

As at December 31,	1954 $ million	1954 %	1959 $ million	1959 %	1960 $ million	1960 %
Canadian Securities	[illegible]	[illegible]	3,740	[illegible]	[illegible]	[illegible]
Bonds	[illegible]	[illegible]	3,510	47.0	[illegible]	[illegible]
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include purchases of insurance stocks for mutualization purposes. It is possible, however, to develop from the Reports of the Superintendent of Insurance general estimates; this source has the added virtue that Canadian common stock purchases may be isolated from trading in preferred shares and in foreign securities. In 1959, the latest year for which such statistics are available, Canadian life insurance companies purchased some $21 million of Canadian common stocks and sold $14 million, indicating a net inflow that year of $7 million. If British life insurance companies had been included, the total would be somewhat higher.

32. From the same source, the market value of life insurance company holdings of Canadian common stocks at December 31, 1959, can also be derived. These amounted to approximately $145 million for Canadian companies, $52 million for British companies and zero for other foreign companies, giving a total of $197 million, or 2½ per cent of total assets. As a matter of general interest, the distribution of assets of life funds in respect of business transacted in the United Kingdom was given in the Radcliffe Report; in 1957 common stock holdings represented about 17 per cent and those preferred stocks 7 per cent. As a proportion of the value of Canadian common stocks listed in Canada, these holdings represented 0.98 per cent. (See Table XV below).

33. Fire and Casualty Insurance Companies. The market value of stock holdings (common and preferred, Canadian and foreign) of fire and casualty insurance

[illegible]
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33. Fire and Casualty Insurance Companies. The market value of stock holdings (common and preferred, Canadian and foreign) of fire and casualty insurance

companies at the end of 1959 amounted to approximately $80 million, representing 3.3 per cent of total assets of $2.4 billion. While this proportion appears fairly low, from Table V it is apparent that annual net demand has in fact been sizeable, averaging $7 million annually between 1955 and 1959. A breakdown of stock holdings at the end of 1959, reveal that out of an estimated total of Canadian equities of some $79 million, common stocks at market value accounted for $69 million, and preferred stocks $10 million.

34. Trust companies. Trust companies form a most important sector and one for which only limited information is available. The figures of net additions to equity holdings appearing in Table V are based on the book value of company and guaranteed funds. Company funds consist of retained earnings, the proceeds of stock issues and in some cases money borrowed from the chartered banks. Guaranteed funds are made up of deposits, on which checking privileges are available, and guaranteed trust certificates; these latter are debt instruments issued by the trust companies, normally with maturities of one to five years; the element of guarantee is provided by the fact that the trust company is required to set aside cash and eligible securities equal to the aggregate amount of these funds. The relatively short-term nature of such liabilities clearly affects the investment policies that are followed; it may be cited as one reason for the apparent modesty of equity holdings. This is illustrated in the following table.

TABLE VII
Trust Company Assets

As at December 31,	1954 $ million	1954 %	1959 $ million	1959 %	1960 $ million	1960 %
Securities	344	58.5	496	49.7	655	54.1
Bonds	326	55.4	463	46.4	620	51.2
Preferred & common	18	3.1	33	3.3	35	2.9
Mortgages	165	28.1	385	38.6	442	36.5
Other	79	13.4	118	11.7	113	9.4
Total Company & Guaranteed Funds	588	100%	999	100%	1,210	100%
Administered Funds	4,056		6,403		6,829	

Source: Bank of Canada Statistical Summary, May 1961.

TABLE VII

Trust Company Assets

As at December 31,	1954 $ million	1954 %	1959 $ million	1959 %	[illegible] $ million	[illegible] %
Securities	344	58.5	496	[illegible]	[illegible]	[illegible]
Bonds	326	55.4	463	[illegible]	[illegible]	[illegible]
Preferred & common	18	3.1	33	[illegible]	[illegible]	[illegible]
Mortgages	165	28.1	385	[illegible]	[illegible]	[illegible]
Other	79	13.4	118	[illegible]	[illegible]	[illegible]
Total Company & Guaranteed Funds	588	100%	999	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]		[illegible]		[illegible]	

Source: Bank of Canada Statistical Summary, May 1961.

35. The proportion of the assets representing company and guaranteed funds made up of equities (foreign as well as Canadian) has not displayed any market trend in recent years; Table V points up the modest role the investment of such funds has played as a net source of demand for stocks.

36. To keep these findings in perspective, it is important to remember that, as at the end of 1960, company and guaranteed funds represented only 15 per cent of total trust company funds, 85 per cent being made up of administered funds (estates, trusts and agency funds and safe custody accounts). In fact, the proportion is lower because book value figures of administered assets are seriously understated: some trust companies, for instance, carry stocks at par and, in the case of no par value, common shares arbitrarily assign a value of $1 a share. The extent of the distortion, however, is unknown; indeed, this is one of the areas where the inadequacy of published information is most striking. Only in the case of pension fund monies managed by trust companies is an asset break-down available; the subject is discussed at some length in the section on pension funds; at the end of 1960, corporate trusteed plans (those administered by trust companies and by Investors Mutual) represented somewhat less than one-third of total trusteed pension funds and involved assets of $1.1 billion. Subtracting these from the total of administered funds on that date, there is $5.7 billion left on which no information is available; as already pointed out, if account is taken

35. The proportion of the assets repre-
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of the deflated nature of book value figures, the total would be increased substantially. It may be assumed that within this total, common stocks make up a significant proportion; while U.S. experience should not be treated as representative of administered funds in Canada, it is of some interest to note that in 1959 personal trust accounts in U.S. banks and trust companies were over 70 per cent invested in equities.

37. College and Endowment Funds.

Figures on investments of college and endowment funds are published annually by the Boston Fund. At the end of 1961, total assets of 62 U.S. colleges amounted to $4,399 million, of which $2,471 million or 56 per cent was invested in common stocks, and $79 million or 1 3/4 per cent in preferred stocks. Information is available on three Canadian universities (McGill, Carleton and Queen's); at the end of 1961 their assets totalled $118.1 million with common stock holdings making up $49.6 million or 42 per cent of total assets, and preferred holdings $2.1 million or 1 per cent of total assets.

38. Mortgage Loan Companies. Book value holdings of preferred and common stocks of mortgage loan companies (including Investors Syndicate of Canada) at the end of December 1960 amounted to $44 million, making up 5.1 per cent of total assets of $860 million. In 1959 the holdings were $41 million, out of total assets of $784 million. On the basis of changes in book values (see Table V), mortgage loan companies, while remaining fairly modest as a net source of demand for

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equities, have been more important than trust companies, considering only the investment of company and guaranteed funds.

39. Pension Funds. Pension funds form an area of institutional investment which is well documented. They fall into three broad categories: trusted plans (most frequently of trust companies) and annuities, notably those sold by life insurance companies and those by the Government of Canada. The Dominion Bureau of Statistics estimates the assets and reserves of all such pension plans in Canada to have amounted at the end of December, 1960 to $5,424 million, with the assets of Trusted Pension Plans (book value) accounting for $3,616 million, those held against Life Insurance Group Annuities in Canada $1,209 million and against Federal Government Group Annuities $600 million. In 1956, the assets of Trusteed Pension Plans were estimated at $1,959 million, Life Insurance Group Annuities $646 million and Federal Government Group Annuities $930 million.

40. Most of the pension plan underwriting by the Government Annuities Branch was done between 1938 (the year it started operations) and 1948; new business done since then by the Annuities Branch has been insignificant. The substantial growth of trusteed and insurance company pension plan underwriting can be dated from the immediate post-war years. Changes in the laws governing such investments have also served to stimulate this growth. An amendment passed in 1956 to the act governing pension funds in Canada freed

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trusteed pension plans from a previous requirement which limited their investments to those legal for insurance companies (including a ceiling of 15 per cent in the proportion of equities). In 1960 the law governing insurance company annuity underwriting was also altered, this same limitation being removed. In recent months a start has been made in Canada in connection with the provision of variable annuities.

41. Pension plans vary extensively as to the composition of their assets. The investments held against insurance company annuities cannot be distinguished, in the statistics that are published, from the overall assets of the companies concerned, on which some comment has already been made in an earlier section. It is in the area of trusteed pension plans that the greatest amount of information is available; they are, of course, in terms of size, the most important of the three. The trusteed pension plans dealt with in the 1960 D.B.S. survey of that name are those of a) industry (incorporated companies, partnerships and sole ownerships), b) municipalities and municipal enterprises, c) federal and provincial crown corporations, d) federal and provincial boards and commissions, e) religious and charitable organizations, f) provincial civil service plans for three provinces, g) teachers' federation plans for seven provinces, h) educational institutions and health organizations such as hospitals, i) trade and employee associations, j) co-operatives. Returns from a total of 1,140 funds were used, covering 1,009,127 employees.

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TABLE VIII

Trusted Pension Plans of Incorporated Companies

Asset Distribution at Book Value	1952 ($ million)	1952 %	1956 ($ million)	1956 %	1960 * ($ million)	1960 * %	Change 1952-1960 ($ million)
Canadian bonds	603.1	84.1	993.9	77.7	1,555.5	72.6	+ 952.4
Mortgages	29.0	4.0	96.9	7.6	167.4	7.8	+ 138.4
Canadian preferred	51.7	7.2	33.5	2.6	24.5	1.2	+ 187.6
Canadian common			72.8	5.7	214.8	10.0	
Foreign bonds, preferred	1.5	0.2	2.9	0.2	2.9	0.1	+ 24.4
Foreign common			6.0	0.5	23.0	1.1	
Other assets	32.2	4.5	73.7	5.7	154.8	7.2	+ 122.6
Total	717.5	100.0	1,279.8	100.0	2,142.8	100.0	+1,425.3
Canadian common, preferred and foreign common	53.2**	7.4	112.3	8.8	262.3	12.3	+ 209.1

* Also includes partnerships and sole ownerships.
** Includes $242,000 in foreign bonds.

Sources: D.B.S. Survey of Canadian Trusteed Pension Funds 1953, Trusteed Pension Plans Financial Statistics 1957, 1960.

42. Within these various groups, the pension funds for which the longest run of historical information has been published are those of industry. They also happen to be the most important single sector within trusteed funds: at the end of 1960, industry plans had a book value of $2,143 million and accounted for close to 60 per cent of the total of $3,616 million. In Table VIII the asset distribution (book value) of the plans of incorporated companies is presented for the three years 1952, 1956 and 1960. The very rapid growth in pension plans in Canada during the post-war period is illustrated in the three-fold increase in total assets between 1952 and 1960. For our purposes, the most interesting point that emerges is the even more rapid rise in equity holdings: in 1952 investments in Canadian common and preferred stocks and foreign common stocks amounted to about $53 million and made up 7.4 per cent of the aggregate portfolio; in 1960, the absolute amount had risen to $239 million and the proportion to 12.3 per cent. If market values were taken, this percentage would be even higher; figures are not available for 1960, but in 1959 the proportion of assets held in equities at market values amounted to 14.1 per cent against 11.5 per cent in terms of book values.

43. From these figures, it would seem that between 1952 and 1960 there was a net flow of funds of $209 million, or an annual flow of $26 million, into the stock market as a result of investment decisions made by the trustees of industry pension plans. If

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foreign equities are excluded, the net inflows come to $188 million and $23 million a year. In connection with the calculation of flows of pension money for investment purposes on the basis of book value figures, it is worth noting that, unlike insurance companies, trusteed pension funds are under no statutory obligation to value their assets and show a state of complete solvency; this means that they can worry less about temporary declines in market prices and, moreover, that they do not have the incentive that the insurance companies have to write down the book value of their assets.

44. Before leaving the subject of industry funds and particularly their role in the Canadian equity market, special mention should be made of the <u>pooled funds;</u> they are, of course, included in the industry total. As suggested by the name, these funds are set up by trustees for the convenience of small firms whose plans are combined, thereby providing the diversity, security and yield that it would be impossible to obtain if each one were to be managed separately. What is particularly interesting is the rapidity of their growth, as well as the emphasis placed on equities. At the end of December, 1960 pooled pension fund assets (book value) totalled $93.7 million, an increase of $30.6 million over the previous year-end, indicating a monthly rate of growth of $2.5 million. The proportion invested in stocks amounted to 26.5 per cent (22.2 per cent in Canadian common stocks), as against 25.3 per cent at the end of 1959. While it would be wrong

[illegible]
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to regard the experience of pooled funds as representative of the way in which fresh pension fund money is being invested, it is certainly indicative of a growing interest in equities.

45. As pointed out earlier, industry pension plans make up about three-fifths of <u>total trusteed pension plans.</u> For recent years, figures are also available for the overall trusteed group. These show that at the end of 1960 holdings of Canadian common and preferred stocks at book value came to $255.1 million and $2713 million respectively (representing 7.0 per cent and 0.8 per cent of total assets). What is particularly revealing is the extremely limited nature of equity holdings in the pension funds of crown corporations and government agencies; the bias towards local debt instruments is also striking. The attached Table IX brings out these two points.

46. Once again, market value statistics do not go beyond 1959; in that year the market value of Canadian common stocks held by all trusteed pension plans totalled $238.6 million, representing 7.8 per cent of overall assets (as against 4.6 per cent of the book value) and that of Canadian preferred stocks $29.5 million, making up 1 per cent of total assets. As a proportion of the value of Canadian common stocks listed in Canada, these holdings represented 1.16 per cent. (see Table XV).

47. In the year 1960, it can be estimated that the net flow of funds into Canadian common stock investment by all trusteed pension funds was $50 million

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TABLE IX

1959
Selected Trusteed Pension Plans

Investments at Market Values	Municipalities & Municipal Enterprises		Provincial Crown Corps. & Govt. Agencies		Fed. Crown Corps. & Govt. Agencies		Religious & Charitable		Educational	
	($ million)	%	($ million)	%	($ million)	%	($ million)	%	($ million)	%
Federal Govt. bonds	14.7	8.4	52.2	17.3	123.5	32.6	5.0	12.2	9.7	3.2
Provincial bonds	32.3	18.3	209.7	69.7	105.7	27.9	9.1	22.0	255.5	75.0
Municipal bonds	87.8	49.8	19.4	6.5	2.3	0.6	8.7	21.0	25.1	8.4
Canadian common stocks	5.1	2.9	.3	0.1	18.2	4.8	2.9	7.1	.5	0.2
Other investments	36.4	20.6	19.2	6.4	129.4	34.1	15.6	37.7	9.8	3.2
Total	176.3	100.0	300.8	100.0	379.1	100.0	41.3	100.0	300.6	100.0

Source: D.B.S. Trusteed Pension Plans, Financial Statistics, 1959.

(of which close to $40 million by industry pension plans); at the same time, there was a net outflow on account of Canadian preferred stocks of $4 million; net investments in bonds and mortgages amounted to about $350 million. This compares with a gross cash flow in 1960 for all trusteed pension plans of $555 million, $393 million representing employer and employee contributions and the rest almost entirely investment income. With expenditures at $154 million ($108 million being pension payments out of funds), the net cash flow in 1960 was somewhat more than $400 million. This would indicate that on average 12 per cent of net funds available for investment is going into Canadian equities.

48. Investment Companies.

From Table V it appears that mutual funds have been easily the most important domestic source of demand for equities in the period covered. In the following table, information is presented on resident-owned investment funds, that is to say, in addition to mutual funds, closed-end funds provided they are largely owned in Canada and excluding Power Corporation and Argus Corporation.

49. While a break-down of investments at book value is not readily available, it may be estimated that in 1959 the net flow of funds into Canadian common stocks amounted to around $80 million. In this connection, of course, the open-end mutual funds are of major importance; the closed-end funds are only significant to the extent that the proportions of their portfolios are switched between equities and debt, or

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Table X

Investment Companies' Assets

(Market value)	1955	1956	1957	1958	1959	1960
		(million dollars)				
Total Bonds	52	62	84	93	112	140
Total Stocks	405	448	400	520	583	598
of which preferred	44	56	55	52	47	54
Canadian common	284	323	287	425	472	467
foreign common	76	69	58	43	64	78
Total Investments	456	509	485	614	695	737
Total investments at book value	325	399	444	478	592	653

because new money has become available for investment as a result of fresh financing. At the end of 1959, with the market value of Canadian common stocks at $472 million, holdings made up approximately 2.28 per cent of the value of Canadian common stocks listed at the time. (see Table XV).

50. Foreign Investment.

Since the end of the war, Canada has been by far the world's largest importer of private long-term capital; this has taken the form both of debt and equity capital. As indicated earlier, the extent of <u>foreign ownership</u> of Canadian enterprises is an important factor limiting the supply of Canadian common stocks.

51. The figures in Table XI cover both direct investment, defined to include concerns which are known to have 50 per cent or more of their voting stock held in one country outside Canada, and portfolio investments, covering enterprises where the holdings are minority in character. The fact that the percentages relate to capital employed and that they cover also direct investment taking the form of wholly-owned subsidiaries means that it is impossible to make precise statements, on the basis of this table, regarding the extent of foreign ownership of Canadian common stocks in certain industries. It does, however, provide a fair indication of the areas where this is heaviest. At the end of 1959 the book value of the capital stock of Canadian companies owned by non residents amounted to $9,916 million, of which $7,117 million in the United States. Of these totals, direct investment accounted for $7,324 million

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TABLE XI

Non-Resident Ownership in Selected Canadian Industries

	Total Non-Resident Ownership			of which by U.S. Residents		
	1948	1954	1959	1948	1954	1959
Manufacturing	42%	47%	51%	35%	37%	41%
Petroleum & natural gas	-	60	63	-	57	57
Mining & smelting	39	53	59	32	47	50
Railways	45	35	27	21	15	9
Other utilities	20	14	15	16	12	12
Total of above plus merchandising	32	32	34	23	25	26

Note: The table describes the proportions of non-resident ownership of the capital employed in selected industries.

Source: D.B.S. The Canadian Balance of International Payments, 1960.

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Source: D.B.S. The Canadian Balance of International Payments, 1960.

and $5,922 million respectively.

52. Additional information is also available on international trade in outstanding Canadian stocks, as distinct from investment flows arising from the flotation of new issues. In Table XII results since 1952 are presented; a positive figure indicates a net inflow of capital into Canada as a result of the sale to non-residents of either Canadian or Canadian-held foreign stocks. The figures, of course, provide no indication of the gross volume of international transactions; that these can be very large is indicated in estimates made by the D.B.S. according to which gross sales to non-residents of outstanding issues of Canadian common stocks in 1959 accounted for somewhat more than one-fifth of the value of the shares traded on the principal exchanges in Canada that year.

53. In Table V, estimates are given of the net investment flows into stocks of N.R.O. Funds and "other foreign portfolio investments". That they do not correspond to the figures presented in Table XII may be largely explained by the fact that Table V includes purchases of new issues. From the statistics presented in Table V, it is interesting to note that in the period 1955-1959 the combined stock purchases of N.R.O. funds and "other foreign portfolio investments" amounted to $887 million, and that those of the Canadian institutions covered in the table came to $555 million. While the incomplete nature of the figures on Canadian institutional buying has to be taken into account, the size of foreign buying in both absolute and relative terms is neverthe-

and $5,922 million respectively.

52. Additional information is also available on international trade in outstanding Canadian stocks, as distinct from investment flows arising from the flotation of new issues. In Table XII results since 1952 are presented; a positive figure indicates a net inflow of capital into Canada as a result of the sale to non-residents of either Canadian or Canadian-held foreign stocks. The figures, of course, provide no indication of the gross volume of international transactions; that these can be very large is indicated in estimates made by the D.B.S. according to which gross sales to non-residents of outstanding issues of Canadian common stocks in 1959 accounted for somewhat more than one-fifth of the value of the shares traded on the principal exchanges in Canada that year.

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TABLE XII

Trade in Outstanding Securities Between Canada and other Countries

	..........Net capital movements in millions of dollars..........										
	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1952-1961
Canadian Stocks	+ 72	+ 21	+129	+138	+188	+137	+ 88	+110	+ 49	+ 40	+ 972
of which with U.S.A.	+ 66	+ 5	+ 87	+ 92	+ 69	+ 5	+ 70	+ 75	+ 54	+120	+ 643
with U.K.	- 6	+ 7	+ 20	+ 28	+ 72	+ 87	+ 4	+ 7	- 16	- 61	+ 141
with all others	+ 12	+ 9	+ 22	+ 18	+ 47	+ 45	+ 14	+ 28	+ 11	- 19	+ 187
Foreign Stocks (U.S.)	+ 9	+ 12	+ 6	+ 26	+ 8	+ 47	+ 10	- 24	- 2	- 5	+ 87

Note: Prior to 1956, the U.K. figures also cover trade with other sterling area countries.

Source: D.B.S. Sales and Purchases of Securities between Canada and other countries.

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54. In order to provide a balanced view of foreign participation in this country's economy, it is only fair to add that occasionally Canadians are given the opportunity to purchase stock in an enterprise that was previously a wholly-owned subsidiary of a foreign firm. Greyhound Lines of Canada is a case in point; formerly wholly owned by The Grehound Corporation of the U.S., in 1958, 20 per cent of its 900,000 common shares to be outstanding were offered to the public. More recently, Esquisite Form Brassiers Canada-Ltd., subsidiary of the U.S. firm, Equisite Form Brassiers Inc. was reorganized as a public company and, in January, 1961, a public stock offering of convertible preferred and common, equivalent to nearly 50 per cent of the equity capitalization, was made. At the time, the president of the parent firm said that the move represented an effort to comply with the wishes of the Canadian Government, which has been urging U.S. companies to make stock in their Canadian subsidiaries available to Canadians. As another example of a company the ownership of which has been repatriated to Canada, mention may be made of Metropolitan Stores of Canada.

55. Before leaving the subject of foreign ownership, it is clearly necessary to mention Canadian ownership of foreign assets. At the end of 1959 total direct investment amounted to $2,309 million; if the equity of non-residents in Canadian assets abroad is taken into consideration, the figure is reduced by about $1 billion. At the same date, the book value of

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TABLE XIII

Non-Resident Control in Selected Industries

	Total Non-Resident Control			of which by U.S. Residents		
	1948	1954	1959	1948	1954	1959
Manufacturing	43%	51%	57%	39%	42%	44%
Petroleum & Natural Gas	-	69	75	-	67	69
Mining and smelting	40	51	61	37	49	53
Railways	3	2	2	2	2	2
Other utilities	24	8	5	24	7	4
Total of above plus merchandising	25	28	32	22	24	26

Note: In calculating control, the total book value is taken of capital employed in companies in which generally 50 per cent or more of the voting stock is known to be held in one country outside Canada. For 1948, petroleum and natural gas is included in the other industries listed.

source: D.B.S. The Canadian Balance of International Payments, 1960.

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57. During the period under review, there has been a consistent rise in the proportions of the manufacturing, oil, natural gas, mining and smelting industries controlled abroad, very largely in the United States, while there has been a steady decline in the importance of the role of foreign investors in railroads and utilities; this latter development reflects in part the growth that has taken place in government-owned railroads and hydro-electric installations.

58. In interpreting these statistics, it should be remembered that the industries chosen are precisely those in which foreign participation is especially important. There are in fact large areas of the economy where foreign investment is insignificant, as, for instance, in agriculture, residential construction and merchandising, while in manufacturing Canadian control predominates in textiles, clothing, beverages, many kinds of food processing and primary iron and steel.

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access to the Canadian market, access to the Commonwealth market or the exploitation of Canadian natural resources; this third aspect of foreign investment has either involved manufacturing in Canada and subsequent export of the finished goods, as in the case of newsprint, or, more commonly, shipment abroad of commodities in a semi-processed or primary form, of which iroe ore, base metals and a number of other minerals are examples. In all three cases, it may be argued that without massive foreign participation, much of the investment would never have occurred, and that the costs of the investment that might have taken place would probably have been higher. The exploitation of less accessible resources and the growing complexity of modern productive processes are two developments which have tended to emphasize the privileged position of those foreign investors who have ready access to plentiful and comparatively cheap sources of capital. In addition, the rapid advances made since the war in science have served to increase considerably the technological requirements of industry, with the result that even if the savings had been available in Canada to finance these expenditures many of the necessary skills would have been lacking. The technological contribution by non-residents to Canadian growth is impossible to assess exactly, but it has undoubtedly been one of the most valuable features of foreign investment.

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In concluding this discussion of the demand for and supply of Canadian common stocks, it may be useful to summarize some of the necessarily tentative findings. In Table XIV,rough estimates are given of the net purchases of Canadian common stocks from certain institutional sources.

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TABLE XIV

Net Purchase of Canadian Common Stocks in 1959

	Million Dollars
Trusteed Pension Funds	$ 53
Life Insurance Companies, Canadian	11
Resident-owned Investment Funds	77
N.R.O. Funds	-10

62. These few figures are no more than a qualification to Table V, the main weakness of which is the mixing of preferred and common, foreign and Canadian equities. As a general comment, the supply of new Canadian equities may be considered to have been fairly limited in much of the post-war period, when viewed in the light of the economic expansion Canada has witnessed.

63. It is apparent from Table V, however, that, in relation to this supply, demand from selected institutional investors and from abroad has been heavy: in the period 1955-59, it was equivalent to three-fifths of new stock issues. That this buying has been concentrated on a limited list of Canadian issues is very roughly illustrated in information available on common stock holdings of Canadian and U.S. investment companies (excluding Power Cor. and Argus). In mid-1961 such companies had holdings of more than 15 per cent of the outstanding shares of Alberta Gas Trunk, Calgary & Edmonton, Calgary Power, Canadian Export Gas, Cassiar Asbestos, Gatineau Power, Greater Winnipeg Gas, Simpsons and Union Gas. Investments representing

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more than 10 per cent of the outstanding common shares included Atlas Steels, Dominion Foundries & Steel, Industrial Acceptance Corporation, Loblaw "A", Moore Corporation and Zeller's. When it is remembered that these proportions concern only investment company holdings, the concentration of institutional interest on a relatively short list of "blue chip" stocks becomes apparent. A further consideration is that where control is held in a limited number of hands, the supply of stock that is potentially available for trading is much reduced. Zeller's is an example, with W.T. Grant having a 51 per cent interest.

64. There are several reasons for believing that this institutional demand has risen since 1959 and may strengthen further. In recent years, for instance, several obstacles to stock ownership have been removed: the relaxation of investment restrictions covering trusteed pension funds and the changes in the acts governing the operations of insurance companies which have permitted the sale of variable annuities are cases in point; the importance of equities in the new pooled pension funds has already been mentioned. In addition, a number of fresh incentives to the ownership of stocks have been created, some directed solely towards Canadian equities. As a result of provisions in the supplementary budget of December, 1960, corporations wishing to qualify for tax purposes as investment companies must obtain at least three-quarters of their gross revenue in the form of dividends from taxable Canadian corporations: for pension plan trustees

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TABLE XV

Institutional Stock Holdings in Canada and the United States

	..........Canadian Financial Institutions..........				....United States Financial Institutions.....		
	Holdings of Canadian Common Stocks at Mkt. Value (Dec. 31, 1959; $ million)	As % Total Assets	As % Canadian Stock Market A	B	Holdings of Equities at Mkt. Value Dec. 31, 1960; $ million	As % Total Assets	As % N.Y.S.E. List
Trusteed pension funds	$ 239	8%	1.16%	1.65%	$ 14,600	44%	3.76%
Life insurance companies	197	2½	0.96	1.37	5,000	4	1.29
Fire & casualty ins. companies	70	6	0.29	0.41	9,000	30	2.32
Investment funds (resident-owned)	472	68	2.28	3.26	14,000	70	3.61
Non-resident-owned (NRO)	331	90	1.60	2.28	-	-	-
Trust accounts with banks and trust companies	N.A.	-	-	-	37,200	73	9.59
Total listed	1,300	-	6.28	8.97	79,800	-	20.58

Notes: A: valued at $20.7 billion being the value of stocks listed on the Toronto Stock Exchange at December 31, 1959, less preferred shares, less U.S. shares, less "penny" mining shares, plus investment grade common stocks only listed in Montreal.

B: valued at $14.5 billion being the same as A less 30% being the estimated proportion of stocks owned on a permanent basis (viz. Inter-company holdings) - and in effect untradeable.

* Valued at $387.8 billion.

N.B. Nearly all figures in this table are approximations.

Sources: Canadian sources have been listed in the preceding text. U.S. sources include "Institutional Investing" by Richard W. Lambourne, Financial Analysts, Nov. - Dec. 1961.

Canadian investors will not set themselves apart from this trend. At the same time, it seems highly desirable that maximum opportunities be provided for investment in Canadian institutions. This may take the form of rendering Canadian stocks more attractive by the removal of certain competitive disadvantages under which Canadian firms operate in relation to foreign companies. In oil and natural gas exploration, development and production for instance, the income tax position of a Canadian corporation or individual is not as favourable as is that of an American corporation or individual. There are of course many other measures that would help to channel investment funds into Canadian equities. As an example of imaginative action in this connection, in Australia, a tax scheme has been evolved permitting an Australian to deduct from his income tax that amount which he can show evidence of having invested in the shares of new companies incorporated for the purpose of exploring for oil.

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In the discussion so far, attention has been drawn on the need to broaden domestic ownership of equities in Canada. Investment dealers and counsellors are very conscious of this and, in their role as portfolio managers, they have done much to improve the situation. The very rapid growth in the post-war period of management services for securities has been

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brought about not only by the demands for sophisticated information on the part of institutional investors but also by the expanding needs of individual investors. On the one hand there has been the desire of the professional investor for more detailed and accurate information concerning companies and their public offerings of securities. Improved communication facilities, broader coverage by daily newspapers and periodicals have stimulated a greater desire on the part of the individual investor for specific advice and information.

68. The pressure exerted on investment dealers for improved investment management advice is to be explained in part by the background of the men assuming senior positions during the past five to ten years within the investing institutions. In the period prior to the war they did little or no recruiting and, perforce, during the war years it was virtually impossible for them to expand their personnel. Subsequent to the war, a much higher percentage of more highly trained people, such as university graduates, were absorbed into the investing institutions. In addition, the increasing appeal of mutual funds and more planned investment of personal funds created greater opportunities within the industry. These highly trained people sought better sources of information on issues which were being offered by corporations, governments, etc., and this created an enlarged demand for the investment management facilities in Canada. Twenty years ago, trust companies and, in some instances,

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69. It might be helpful to list the various types of investors who require, either on a regular or on an intermittent basis, advice concerning their investments:

Estates
Trusts
Personal Accounts
Investment Trusts
Mutual Funds
Pension Funds
Corporate Accounts

The type of service ranges from the determination of an overall investment policy to the provision of specific information on particular issues making up a portfolio.

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73. The securities in question can only be chosen after their merits have been carefully weighed by people highly trained in this type of research work.

It is necessary for a firm, supplying investment counsel information, to maintain a research department devoted to a continuous, impartial and, perforce, relatively successful analysis of given situations. In certain instances, firms will emphasize certain types of securities and confine their research efforts to those particular areas, but firms which offer a comprehensive investment management service must cover a broad field in Canada. This comprises extractive industries, secondary and primary manufacturing industries, and service organizations. It requires the training and development of competent personnel, who must have adequate educational background to give them the ability to collate and classify the appropriate material.

74. It has been estimated that to bring a college or university graduate to the status of a recognized analyst takes a period between four to six years. This indicates that a firm must make a fairly sizeable capital investment in an individual in order to bring him to the point where he can be useful in research. Figures in themselves are not conclusive, but it would seem that a fair estimate is that a capital investment of some $40,000 to $50,000 would be relatively modest outlay in order to produce one good senior investment analyst. If this thought is pursued a little further, and assuming that,over a five-year period, a firm would be extremely fortunate in retaining on a permanent basis three out of seven trainees, there has to be a substantial capital investment made in order to produce the type and calibre of information required to

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provide the basis for successful investment or portfolio management.

75. The training, either on a permanent or a replacement basis, is, in itself, only part of the capital costs of maintaining adequate research facilities. There are substantial capital outlays for the production of informative services, involving, for instance, the use of consultants in a particular field, either on a regular or sporadic basis. In addition, it is not only desirable but necessary to provide facilities for the research staff to make extensive field trips to the industries and companies whose activities they are analyzing so as to give them first hand knowledge of the potentialities of companies on a short-term or long-term basis. Finally, it is vital that national and international channels be developed for critical information forming a basis for the appreciation of world trends, etc. This is a costly and time-consuming operation involving capital expenditures in proportion to the coverage desired.

76. It might be pointed out in conclusion that, where investment management or portfolio advice is offered as an auxiliary service by an investment house, there is usually no added fee to the client other than the normal brokerage or commission which is chargeable on transactions. Investment counsels, however, who operate solely for that purpose do levy a fee on a varying scale in accordance with conventional terms.

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77. THE IMPORTANCE OF CORPORATE PUBLIC RELATIONS POLICIES

With the best will in the world, investment dealers and counsellors would have great difficulty making sophisticated judgments on individual securities without the co-operation of the companies concerned. Indeed, competent reporting to shareholders and to the public at large is indispensable. Remarkable progress has been achieved in this respect during the past three decades, and some Canadian companies are among the leaders in the public relations field on this continent; a few of them have figured prominently in the list of trophies awarded for best annual reporting.

78. On the other hand, one must recognize that many Canadian corporations are not giving to the public, holding their shares, the information to which they are entitled. While it is hard to outline a fixed set of rules, it would seem that once a year at least, on the occasion of the annual report, shareholders should be given as complete factual, pictorial and graphic information about the company as possible. This should include interpretation of the company's activities and policies in relation to conditions within its industry, the information being presented in such a way as to afford easy comparison with previous performance. The publication of sales figures, in this connection, is most desirable. In order to make it meaningful for the average shareholders, the report should be written in layman's language, with clear explanations of technical financial terms.

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79. Preferably, information given to shareholders should not be limited to the annual report. Interim statements, on a quarterly or semi-annual basis, are highly desirable and these should carry concise information on events affecting the company during the period covered by the interim report. Speeches made by the Chairman or the President at the annual meetings as well as answers given on that occasion to shareholders' questions should also be part of the informative material supplied annually to shareholders. It is also important that each company sees to it that any information pertaining to its activity, capitalization, earnings or dividends, which could materially affect the performance of the shares on the stock exchange, be given as early and as clearly as possible, and with wide and simultaneous distribution.

80. The challenge of gaining investors' confidence through sound public relations policies is a substantial one, but so are the rewards of communication with an audience of growing importance.

81. <u>INVESTMENT CLUBS IN CANADA</u>

In discussing efforts made to broaden stock ownership one must mention investment clubs, in view of the important part they are playing, with the help of members of the Investment Dealers Association, in educating the small investor.

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a) To provide their members with an opprtunity to jointly study securities so as to broaden their investment knowledge;

b) At the same time to enable them to make their personal savings work.

83. In many instance, for two or three years the amounts of capital available for investment are minute. This means that transactions effected by these groups, if they are to have any diversification in their investments, are confined to very small lots of stocks. It is an accepted fact that the odd-lot transaction is an umprofitable one to the broker concerned, and generally the experience in dealing with investment clubs is that of carrying business at a loss. On the other hand, there is the hope that future

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84. CO-OPERATION BETWEEN STOCK EXCHANGES INVESTMENT DEALERS ASSOCIATION

Much of the public financing of Canada's post-war expansion has been done through Investment Dealers Association members across Canada.

85. In the case of equities, the value of listing on a stock exchange as a means of providing a known and ready market has been decisively demonstrated. This has made for closer co-operation between Investment Dealers Association members and the stock exchanges than existed in earlier periods of Canadian development, when equities were not as widely held by the public.

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87. CONCLUSIONS AND RECOMMENDATIONS

(a) In this discussion, a recurring theme has been the inadequacy of the available statistical material. Such shortcomings are glaring in the case of the investment of funds administered by trust companies. It is recommended that the Dominion Bureau of Statistics give high priority to having the relevant material assembled and published.

(b) On the basis of those statistics that are available, it appears that the proportion of individuals in Canada owning stocks is not very different from that in the United States; this may be in part due to the incentive to stock holding provided by the 20 per cent dividend tax credit. It is recommended that this be fully maintained and that further study be devoted to the subject of minimizing double taxation. On the other hand, it is suggested that the Commission examine the participation in the stock market of Canadian financial institutions and pension

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(c) It is recommended that efforts be made to remove some of the competitive disadvantages under which some Canadian firms operate in relation to foreign firms.

(d) In regard to the goal of furthering ownership of Canadian equities in Canada, while much has already been done by the companies, the stock exchanges and investment dealers, in close collaboration with the Investment Dealers' Association, further improvements are certainly possible and every effort should be made in this direction.

(e) While it seems highly desirable for Canadian stock ownership to be broadened, the valuable role played by foreign capital in Canada's post-war development should not be overlooked. It is to be hoped outside money will continue to perform an important function in the years to come and, in this connection, it is vital that the favourable business climate that has been characteristic of this country be maintained.

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APPENDIX K

MUTUAL FUNDS

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Submission by the Investment Dealers' Association of Canada to the Royal Commission on Banking and Finance

APPENDIX - Mutual Funds

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2. The concept of investment trusts was really nurtured in Great Britain. In 1868, the Foreign and Colonial Government Trust was founded for the express purpose of providing "the investor of moderate means the same advantages as the large capitalist, in diminishing the risk in Foreign and Colonial government stocks, by spreading the investment over a number of different stocks". By 1875, eighteen trusts with a paid in capital of over £6.5 million had been formed. During the 1880's the number of trusts more than doubled and the movement was only halted by the Baring Bros. Crisis in 1890.

3. The majority of earlier British trusts either had a termination date or provision in the charter for a gradual redemption of its certificates. A fixed rate -- usually 6 per cent -- was payable on the certificates and earnings in excess of this, after allowance for expenses were used to redeem certificates and/or set up a surplus. It was a normal procedure

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4. The investment company concept was slow to develop in the U.S.A. The first recorded concern is Boston Personal Property Trust that was formed in 1893 and which is still in operation. It has the enviable record of paying dividends every year since its inception. The first United States companies were similar to the British trusts with the exception that few of them had specific terminating provisions. The conservative policies which were a characteristic of the British trusts had limited appeal to the more adventurous American and they attracted little attention until the late 1920's.

5. Of particular interest was the formation in 1923 of a "fixed trust" called United Bankers Oil Company which may be regarded as the real father of the modern Mutual Fund. A specified number of shares of ten Standard Oil companies were purchased and deposited as a unit in trust. Seven hundred "bankers shares" were issued against each unit of 144 shares. Several "fixed trusts" were formed during the next few years.

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7. The speculative fever of the late 1920's found reflection in the investment companies. Between 1927 and 1930, over 700 investment trusts and investment holding companies, nearly all of which were closed-end, were formed in the United States. All too few of them subscribed to the real tenets of an investment trust and the majority could only be described as proselytes from the conservatism of the true trust. Substantial leverage in the form of debentures and preferred stock was magnified by a combination of pyramiding of one investment company into another with the common shares often having a market price in excess of the break up value.

8. In Canada, investment trusts were also relatively slow in developing. The initial trusts tended to specialize in one industry and in some respects were more holding companies than investment companies. They were practically all closed and management companies.

9. Amongst the first to be formed were Canadian Power and Paper Investments, Ltd. incorporated in 1920 and Power Corporation of Canada, Ltd. formed in 1925. By 1929 there were 49 such investment companies with assets in the order of $265 million. Some $230 million of this total was concentrated in nine trusts with Power Corporation of Canada Ltd. being by far the largest with assets of over $60 million and Consolidated Investment Corporation of Canada second with investments of $30 million.

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12. Nevertheless, Canadian investors lost heavily on the "investment trusts" and the very term became an anathema to them. It is probable that Canadians were influenced to a degree by the understandably bitter attitude of U.S. investors towards trusts. Management as applied to investments was at a discount and the public wanted no part of it.

13. Inherently, however, the individual of more modest means still sought ways of investing to provide a combination of diversification over a known list of companies, a redemption or liquidation feature and equally importantly, ways of establishing the proper market value of his commitment.

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15. The fixed trust movement made limited headway in Canada. There are records for 1931 of four Canadian fixed trusts of which two confined their investments to purely Canadian stocks, while the two others deposited both Canadian and U.S. stocks with their trustees. Several of the larger U.S. fixed trust shares were offered for sale in Canada but the response was not good. Unfortunately there are no accurate records available as to total sales of fixed trust shares in Canada. At the end of 1961 there were only two Canadian fixed trusts reported -- Diversified Income Shares of which there are two series and Trans-Canada Shares with three series of trust shares.

B. ADVENT OF MUTUAL FUNDS IN CANADA

16. The year 1932 saw the start of a new movement in investment companies in Canada with the incorporation by Calvin Bullock of Canadian Investment Fund, Ltd. the original mutual investment company of management type in Canada.

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18. Today there are upwards of 41 mutual funds incorporated in Canada. Of these (a) 24 are essentially Canadian owned and generally come under the definition of Canadian investment companies under the Income Tax Act; (b) 4 are primarily Canadian owned with foreign investments; (c) 3 are owned primarily abroad with investments in Canada, and (d) 10 are non-resident-owned companies registered under the United States Investment Company Act of 1940. A list of the various companies and other details are given in Exhibit A.

19. Total Net Assets at market in Canadian dollars at the end of the 1960 (calendar or closest fiscal year) of the various mutual funds incorporate in Canada and investing in Canadian securities was $900 million.

20. While an investment company may be defined as an organization that combines the capital of many persons for the purchase of securities, the definition is far from adequate and in particular it makes no reference to professional management.

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investment company to the investing public. "The fund was formed with a view to providing a convenient medium for diversified investments under careful supervision".

22. This concept pertains basically to both closed and open end investment companies. Both types have a definite and useful role in the overall financial community and both have their advantages and disadvantages from the investors' as well as the capital users' points of view. It is beyond the purpose of this submission to make a comparison of the respective contributions of the two types of the capital markets. Nevertheless, it has to be admitted that the dynamic growth of open-end funds in North America during the past fifteen years when compared with the relatively static position of closed-end investment companies is convincing testimony that collectively mutual funds are developing into an increasingly important sector of the financial markets. See Exhibits D and E.

C. A TYPICAL CANADIAN MUTUAL FUND

23. While there is a wide variation in objectives, management policies, procedures and operations amongst the individual mutual funds in Canada, they have sufficient features in common to permit the preparation of a description of a prototype or typical Canadian mutual fund. This prototype, in addition to being a corporate picture of a mutual fund, serves as a yardstick for measuring deviations from the average practice employed by funds to achieve their individual objectives.

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simple capital structure consisting of a large number of redeemable special shares and a very small number of deferred shares which latter would be held by the management group. Both classes of stock have full voting rights. The holders of the Special Shares would have the right at their option to present their shares to the company for redemption at the net asset value, whereas this privilege is not available to the deferred shareholders. In all other respects the stocks rank pari passu.

25. The company would be prohibited from borrowing money, buying securities on margin or selling short. Its investments would consist of possibly 70 different common stocks of prominent Canadian companies and some common stocks of a few large U.S. corporations -- 15 per cent of the investments would be in preferred stocks and corporate bonds, a portion of which would have a conversion or similar feature and depending upon the state of the markets a larger or smaller amount of Government of Canada bonds.

26. The by-laws of the fund would prohibit it from placing more than 5 per cent of its assets in the securities of any one corporate issuer and would also prohibit the holding of more than 5 per cent of the voting securities of any one corporate issuer.

27. Dividends would be paid quarterly out of the income received by the fund on the securities held after allowance for corporate and other expenses. It is probable that the fund had also made provision, whereby, if the shareholder wishes, the dividend is invested, at

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no cost, in the Special Shares of the fund. Shareholders would also receive, quarterly, a list of securities held by the fund, together with information as to changes made during the quarter.

28. The fund would be operated by an investment management organization that in addition to providing office accommodation, administrative and clerical services would supply the complicated research work necessary in the professional management of the company's portfolio. Such management would be subject to the control of the nine man board of directors, four of which might well be connected with the management organization.

29. The management fee would be one half of one per cent a year of the average daily net asset value of the fund, calculated and payable on a quarterly basis. Other expenses of the fund would include security transaction commission, custodian, legal, dividend paying and auditing fees together with the usual costs of shareholder reports, annual meetings, etc.

30. There would be adequate provision in the fund's charter to ensure "arms length dealing" with the investment management and members of the board of directors on all transactions other than those conducted in securities listed on a stock exchange where regular commissions or brokerage are charged.

31. The underwriter of the funds Special Shares would be the investment management organization. It would purchase the shares at their net asset value

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and sell them to investment dealers who in turn would sell them to their clients. The retail price would be the net asset value which would be calculated daily, plus a loading charge of 8 per cent of the offering price. The fund also has a sliding scale of loading charges whereby the load is reduced to 5 per cent with the purchase of $50,000 and to lower rates as the total purchases increase.

32. The bulk of the loading charge would be paid to the investment dealer who has undertaken to sell the special shares only at the net asset value plus the specified loading charge. The balance of the loading charge is retained by the underwriter to defray the expenses of prospectuses and other sales literature, advertising, etc. This charge is commented upon in more detail in paragraphs 48 to 55 inclusive.

33. The investment management organization, which is also the underwriter, has followed the practice of managements of several other larger Canadian funds of having its own sales force to sell the Special Shares direct to the public in addition to selling them to investment dealers.

D. CENSUS OF CANADIAN MUTUAL FUNDS

34. For the purposes of this study 41 mutual funds incorporated in Canada have been examined. There are a few additional funds in Canada but these are all small and it is questionable if their combined net assets at market exceed $500,000. Also excluded from this count are mutual funds that invest only in the shares of an affiliated mutual fund. An example

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of this (as shown in Exhibit A) is All-Canadian Compound Fund that purchases only the shares of All-Canadian Dividend Fund.

35. Of the 24 Canadian owned mutual funds studied, 12 are classified as balanced funds, 7 are essentially common stock funds and 5 are considered specialty funds. The term "balanced fund" indicates that the objectives of the fund include both a regular reasonable income and capital appreciation. The common stock fund usually has capital growth as its major objective and might well be called a growth fund.

36. The specialty funds are those that have some feature that separates them from the other two groups. Of the five specialty funds, two concentrate their investments in Canadian oil and gas and related companies; one is a mutual bond fund, one purchases only the shares of three other designated mutual funds and one has a leverage feature whereby under specified conditions it is permitted to borrow money. This feature has not been used during the past four years.

37. The seoond group of mutual funds, shown in Exhibit A, are funds incorporated in Canada with their principal assets being Canadian securities but whose shares are distributed largely outside of Canada. It is not known whether sufficient amounts of their shares are held externally for them to qualify as Non-Resident-Owned Investment Corporations. All three unfds are classified as the balanced type.

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Corporations which are registered under the United States Investment Act of 1940. There are ten of these. None of them pay dividends and all reinvest their income. Accordingly, they should be classified as growth funds.

39. The fourth group are Canadian incorporated mutual funds owned by Canadian investors but with their investments being made in the United States and Europe. There are four of these. All of them are classified as growth funds.

E. TAXATION

40. The Canadian Government has recognized the need of investors who wish to have the protection afforded by a diversified investment portfolio but who at the same time may not have the means, time or facilities to create and operate efficiently such a portfolio, but granting tax concessions to those which wish to pool their resources in an investment company that complies with conditions specified in the Income Tax Act.

41. Those sections of the Income Tax Act pertaining to Investment Companies (Section 69) and to Non-Resident-Owned Investment Corporations (Section 70) are given in Exhibit B.

42. Investment companies (domestic) pay a tax of 21 per cent of their taxable income providing they meet certain requirements and at the same time because the investment company is not exempt from tax, the Canadian shareholders of such a company are not precluded from claiming the 20 per cent dividend credit

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under Section 38 of the Act.

43. To qualify as an "investment company" the following conditions must be met by the company:

(a) At least 80 per cent of its property, through the year, must be securities or cash.

(b) At least 95 per cent of its income must be derived from the investments mentioned in A.

(c) Not less than 85 per cent of its gross revenue is from sources in Canada. Investment companies with less than 85 per cent in the 1962 tax year but 75 per cent or more are given to the 1963 tax year to meet this requirement.

(d) Not more than 25 per cent of its gross revenue for the year was from interest. Companies with a higher gross from interest are given until 1963 to comply with this requirement.

(e) Other than Government, Provincial and Municipal securities not more than 10 per cent of its assets must be in the securities of one corporation.

(f) There must be a minimum of 50 shareholders, none of whom hold more than 25 per cent of the shares of the investment company.

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to its shareholders before the end of the taxation year at least 85 per cent of the taxable income after allowing for the tax paid. Shareholders are entitled to the usual depletion allowances. Dividends paid to non-resident shareholders are subject to the 15 per cent withholding tax.

44. <u>Non-Resident Owned Investment Corporations</u> are also not subject to the usual rates of corporation income tax providing such an investment company elects to be so classified and meets the necessary qualifications. This special class of taxpayer was originally established to attract foreign capital to Canada.

45. Providing that the company qualified as a non-resident-owned investment corporation under Section 70 of the Income Tax Act it is subject to tax of 15 per cent on the taxable income as determined in the manner prescribed in the Act.

46. Briefly the major requirements for a company to qualify as a N.R.O. investment corporation are:

(a) At least 95 per cent of the aggregate value of the issued shares and 100 per cent of its bond or other indebtedness must be beneficially owned by non-resident persons.

(b) The second general qualification relates to the source of income which must be limited to that from:

[illegible]

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(b) The second general qualification relates to the source of income which must [illegible]

i. ownership or trading securities, bills, notes or other property.

ii. lending money

iii. rents, hire or chattels, annuities, royalties, etc.

iv. estates or trusts.

(c) The principal business of the N.R.O. corporation shall not be the making of loans or the trading or dealing in mortgages, hypotheces, bills, notes, etc. Not more than 10 per cent of the company's gross revenues may be derived from rents, hire of chattels or charter party fees.

(d) While the company may receive its income from almost any type of property as mentioned in (b) and (c) it must derive no revenue from business activities such as purchasing, processing, merchandising, manufacturing or similar activities. The receipt of any income that does not qualify disqualifies the company in toto.

F. SELLING COSTS

48. The majority of mutual funds charge the purchase a fee, or selling charge which is over and above the net asset value of the shares. This fee -- commonly called the "loading" -- is, in Canada, usually between 8 per cent and 9 per cent of the offering price of the shares. Normally the loading is scaled down as

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49. A few mutual funds in Canada have a low loading charge or no charge at all at the time of purchase but levy a small redemption fee when the shares are presented for redemption.

50. It is often claimed by superficial observers that in relation to normal commission charges on the Toronto or Montreal Stock Exchanges the "loading charges" are exorbitant. Such a comparison is both fallacious and misleading as the two things compared are entirely dissimilar and several important factors are ignored.

51. A share of a mutual fund is not an ordinary "security". It not only represents pro-rata ownership in the net assets of the fund but it is in effect a service contract entitling the holder to the benefits of constant professional management at very low cost of his interest in a highly diversified and large portfolio.

52. Mutual funds shares in common with goods, services and insurance have to be "sold" and the real benefits of diversification and professional management can only be obtained if a sufficient number of shares are sold to provide a large pool of capital. Those engaged in the creation of such a pool are entitled to compensation for their efforts.

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54. Another aspect that should be considered when examining the offering price and redemption price of mutual fund shares is the spread between the bid and asked prices that normally prevail both on listed stocks and those traded over-the-counter. Set out in Exhibit C is an analysis of the difference between the total cost of the purchase of the first fifteen common stocks on the Montreal Stock Exchange at the closing asked prices and the proceeds when they are sold at the closing bid prices for four separate days. The percentage spread between the Total Cost and the Net Proceeds ranged between 6.84 per cent on July 21, 1957 and 4.45 per cent on May 31, 1960.

55. The calculations set out in Exhibit C cover the purchase and sale of more than "board lots" of each stock. If, however, the individual sought some diversification by spreading a modest amount of money over a number of stocks he is likely to encounter minimum commissions and when buying or selling small or odd lots of stock a wider than normal spread between the bid and asked prices. Accordingly it is likely that the percentage spread would be higher than the examples given in Exhibit C.

G. MARKETING OF MUTUAL FUNDS

56. Shares of mutual funds in Canada are, for the most part, sold in one or a combination of three ways. The underwriter, which is usually the fund manager, purchases the shares from the mutual fund and

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57. In addition to mutual fund sales made as individual transactions which are conducted in the same manner pertaining to other securities, mutual fund sales are also made in increasing amounts under whare are known as Accumulation or Regular Purchase Plans under which the investor is able to take advantage of "dollar cost averaging". By this is meant that the individual invests a stated amount of money at regular intervals in the shares of a mutual fund. His money will buy more shares when prices are down and less shares when prices are high. It is arithmetically proveable that at the completion of a market cycle -- namely when a recognized stock exchange inded of common stocks returns, in due course, to the level existing at the time of the investor's first purchase -- it will be

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found that the market value of the combined holdings exceeds that paid for such holdings, entirely apart from any dividends that may have been received in the interim. It must be assumed that the price of the mutual fund shares will move in reasonably close conformity with the stock exchange index that is being used as a yardstick. In most cases, however, it will be found that, because of the professional management, the mutual fund shares will have done better than the averages.

Accumulation or Regular Purchase Plans.

58. Generally speaking these plans are based on regular contributions on a monthly, bi-monthly or quarterly basis. Dividends may or may not, as decided by the investor, be reinvested, usually at no cost to the investor.

59. (i) Voluntary Plans - These provide a systematic method whereby the holder elects to make periodic (usually regular) purchases of a mutual fund. The bookkeeping details, reinvestment of dividends, T-4 slips, quarterly and annual reports, etc., are usually handled by the underwriter of the fund or by an independent trust company whose services are employed by the fund management.

60. The holder has the right to terminate or liquidate his plan at any time without penalty. If he decides to present his shares to the fund for redemption, he will receive the net asset value prevailing at that time.

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years the number of contractual plans being sold have increased rapidly in Canada. This may be attributed mainly to the type of distribution being carried out by the direct sales forces of many of the funds underwriters' and also independent organizations that are engaged in selling several variations of the contractual plan.

62. Under the contractual plan, the holder agrees to make contributions for the purchase of a mutual fund shares of stipulated amounts at regular specified intervals for a pre-determined number of years, usually ten, fifteen, or twenty years. The terms of the contract carry certain penalties to the holder in the event that he is unable to continue his payments until the maturity date of the plan.

63. Contractual plans for some mutual funds have what is known as a "front-end load". Under such a plan a material part of the total load which would be paid to carry the plan to completion is concentrated in the first two or three years of the plan. The result is that if the investor is forced to terminate the plan in the earlier years of its life, he will only recover part of the total amount he has paid in. Certain provincial regulatory bodies have objected to this "front-end loan" practice and at least one fund sales organization was required to modify its contractual plan and lower the "front-end load" on sales made in those provinces. Later, the sales organization voluntarily introduced the modifications for sales in all provinces. It should be noted that the loading charge per share of

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the fund is unchanged from that pertaining to regular sales but a major portion of the total is collected early in the contract in anticipation of subsequent share purchases.

64. In effect, the contractual plan employs the principle of compulsory savings which to some investors may well be beneficial. On the other hand, it cannot be overlooked that if for some involuntary reason the purchaser has to terminate the plan in the earlier years of its life, he could suffer a material loss of capital without the interim compensating feature which applies to insurance.

65. Many contractual plans offer a form of reducing term insurance at additional cost to the holder. In most instances the combination of the insurance and the contribution will provide the beneficiaries with the face amount of the plan in the event of the holders death.

66. By far the greater majority of regular purchase plans are directed to small investors -- those people are are able to save and invest from $15 to $100.00 per month. Most mutual funds, after an initial moderate deposit, carry a low minimum contribution under the voluntary plan. This in many cases is as low as $100 per year. Contractual plans may have a minimum deposit as low as $10 a month and often require no initial deposit of larger than this amount.

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67. In 1957, the Government of Canada amended the Income Tax Act to permit any Canadian whether

employee or employer to make certain tax exempt contributions to a Registered Pension Plan which would provide funds for retirement years.

68. Under the terms of the Plan, a self-employed person may contribute each year up to 10 per cent of annual earned income with a maximum of $2,500 and such a contribution is deductible from taxable income. For those who are members of a group plan, to which their employer also contributes, the maximum deduction is $1,500. When contributions to such group plans are less than the maximum tax deductions permitted, the individual taxpayer may establish a supplementary individual registered pension plan so as to obtain the full benefit of the allowable deduction.

69. The plan-holder has the option of converting the assets of the Plan to an annuity at any time prior to his or her 71st birthday, at which time the assets will automatically be converted under the terms of the Plan.

70. Mutual funds qualify as an investment medium for Registered Retirement Savings Plans. As a result of the introduction of Registered Pension Plans in 1957, a new outlet for fund sales has developed.

I. WITHDRAWAL PLANS

71. A number of mutual funds provide what amounts to a bookkeeping service whereby a shareholder who had acquired a block of shares of the fund (either as a lump purchase or by gradual accumulation) may elect to liquidate a portion of his holdings at stipulated

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regular intervals -- usually monthly but in some cases quarterly or annually.

72. This service is not in any way the payment of an annuity but constitutes simply a convenient method for a shareholder to gradually withdraw invested capital for other purposes -- usually to supplement other sources of revenue. It has the advantage from the shareholders point of view of economy. In most cases the dividend being received on the shares still held are reinvested at no cost and there is no charge for the liquidation of shares.

73. The usual options available to the shareholder are:

(i) The liquidation of a sufficient number of shares on a given day each month to provide the shareholder with a stated number of dollars.

(ii) The liquidation of a stated number of shares on a given day each month until all the shares have been redeemed. In this case, the number of dollars received will vary with the price of the stock.

74. Most of the funds providing this service require a minimum purchase or accumulation of $6,000 in its shares at the commencement of the service and that, under option one, not more than 10 per cent of the initial invested capital may be redeemed each year.

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J. CANADIAN MUTUAL FUND EXPERIENCE

76. A study of mutual funds in Canada is rendered more difficult because of the absence of a central supervisory body of a similar nature to the U.S. Securities and Exchange Commission to which American investment companies must report. The student of the American scene is further helped by the presence of the National Association of Investment Companies -- a non-profit organization maintained by the great majority of important registered investment companies in the United States.

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81. Set out in Exhibit D is a record of the growth of the five largest of the Canadian owned, domestic mutual funds from the years 1950 to 1961. These five companies at the end of 1960 represented approximately 82 per cent of the total net assets (at market) of all the 24 Canadian mutual funds and accordingly could be considered representative in the absence of detailed statistics of other funds in the earlier years. The consistent growth over the years under review of combined net assets of over 1000 per cent is considered impressive and indicative of the acceptance of mutual funds as an investment instrument.

82. Exhibit E shows the growth of United States mutual funds during the years 1940 to 1960 when Total Net Assets increased from $448 million to $17 billion. The increase from 1950 to 1960 was approximately $14.5 billion or roughly 500 per cent.

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85. Hugh Bullock, one of the leading figures in the United States investment industries, states:

> "The NIAC has figures from its mutual fund members (representing 74 per cent of the assets of its mutual fund members) showing that during the 18 per cent stock market decline from May to October in 1946, the public purchased shares from such funds valued at $98 million and asked the funds to redeem $39 million worth of their shares. Meanwhile the funds' purchases of portfolio securities were $117 million and their sales of portfolio securities $72 million. Ninety-six per cent of the members of the NAIC (by assets) reported that at the outbreak of the Korean War, when the market declined 7 per cent during the week ending June

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L. CONCLUSION

96. The gradual and accelerating interest in equities throughout the Free World during the past sixty to one hundred years may be regarded as the natural evolution of man's desire to share or participate in the growing economy of the nations and thus increase his stature. It may also be said that the right as an individual to own a share in individual segments of an economy is an inherent part of the capitalistic system.

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103. There is a sufficient allowance in the sales charge (loading) to permit salesmen to cover the smaller investor personally in the city and even more so in rural areas which previously have not been serviced investment-wise to any large extent except by correspondence because it has not been possible to do so economically with the small percentage margin presently available on listed securities and in many large corporate underwritings.

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102. The features of redemption of shares at the holders option and professional management operating to certain established standards in a goldfish bowl alone do not, however, account for the growth of mutual funds. The other aspect is that, in common with most forms of merchandise, they have to be sold. Mutual funds provide a service which the investment dealer or a direct mutual fund salesman can afford to sell. At the same time the service fills a need not before covered, particularly for the small investor who does not have sufficient resources to justify the employment of investment counsel or who had neither the facilities nor the interest to be reviewing constantly his or her own securities.

103. There is a sufficient allowance in the sales charge (loading) to permit salesmen to cover the smaller investor personally in the city and even more so in rural areas which previously have not been serviced investment-wise to any large extent except by correspondence because it has not been possible to do so economically with the small percentage margin presently available on listed securities and in many large corporate underwritings.

104. The combined net asset value of all Canadian mutual funds investing their resources in Canada at the end of 1961 is estimated to be in excess of $1 billion. There is no way of measuring accurately the effect of the impact of the contribution of such a sum of capital upon the Canadian economy although it must be appreciable proportions. It is also suggested that the mutual fund sales efforts have tended to promote individual savings with an accompanying increase in money reaching the Canadian capital markets.

105. Another plus factor for mutual funds which again cannot be measured in precise terms is that they have made available to the smaller investor a sound, marketable security which in most cases is paying fair dividends that has, in many instances, taken the place of very speculative securities which have been sold by high pressure methods and without regard for the investors circumstances and requirements.

106. While it is not amenable to statistical proof, there appears to be little question that the mutual funds have a stabilizing influence in the stock market. It has been demonstrated in previous paragraphs (83 - 91) that over the years, in periods of declining markets, the mutual funds have on balance been net purchasers of securities.

107. Mutual funds have in their portfolios very large amounts of the shares of individual companies. Purchases and sales under professional management, however, are usually executed gradually over a longer period of time so that, if anything, mutual funds

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transactions tend to have a stabilizing influence upon the market.

108. For the individual mutual fund shareholder the understanding that he can always redeem his shares at their net asset value and not be subject to the whims of fluctuating investor confidence in any individual situation and never be locked in to the stock combined with a detailed knowledge as to how his money is invested by professional management in a well diversified portfolio is likely to result in a sale only when the money is required for other purposes.

109. From the Canadian mutual fund point of view, certain difficulties are experienced in regard to availability of Canadian representation of appropriate quality in some industries such as electronics and automobiles together with the narrow market that exists for the stocks of some companies. The condition is not one for which there is any immediate solution. Certain types of industries have not developed to a point where public distribution of their equities is a feasible undertaking. An increasing number of subsidiaries of foreign corporations operating in Canada are making their securities available to the Canadian investing public. This, however, cannot be regarded as the complete solution as such companies are likely to be operating only in Canada whereas their parents probably will be international in scope and have a much wider diversification of products.

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in its view and if it is to exercise its policies to the maximum benefit of its shareholders it must be, within reason, permitted to diversify its investments without regard to national boundaries.

111. While the present requirement under the Income Tax Act that not less than 85 per cent of the gross revenues is from sources in Canada for a mutual fund to qualify as an investment company and be entitled to the 21 per cent income tax rate, this has not, as far as is known, been a hardship on any of the mutual funds.

112. There is in Canada no special regulatory legislation for investment companies as such at either federal or provincial levels that in any way parallels the United States Investment Companies Act of 1940 which is administered by the Securities and Exchange Commission. All mutual funds in Canada are, however, subject to the federal or provincial acts under which they are incorporated as well as the various securities acts of the provinces where their shares are being offered for sale.

113. While none of these respective acts set out regulations in the specific manner of the United States Act, it is particularly worthy of note that the various Canadian mutual funds have voluntarily and individually prescribed for themselves regulations that are of a high standard.

114. No amount or kind of government regulation can guarantee good investment management or insure investors against losses. Nevertheless, it is contended

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that in the absence of special regulatory legislation pertaining to investment companies at either or both federal or provincial levels the various provincial Securities Commissions may be faced with some difficulties in protecting the investing public.

115. It is beyond the scope of this submission to discuss investment company regulations in detail. It is suggested, however, that the Commission satisfy itself that present provincial legislation provides adequate safeguards for the protection of shareholders of both open and closed end investment trusts.

116. As the sale of few if any mutual funds will be limited to one province it is essential that there is uniformity of legislation and its administration in all provinces.

117. To date, mutual funds in Canada have been essentially conservative in concept and accordingly their shares are appropriate instruments for a broad range of investors. It is logically to be expected however that in the future mutual funds of a more specialized and speculative nature will be formed and indeed such funds could well serve a useful purpose. The investor who is in a position to commit moderate amounts of risk capital in mining or oil enterprises would be provided with the advantages of employing technically qualified specialists at relatively low cost per investor in the investment of the money.

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brokers who weremembers of the Investment Dealers' Association of Canada and/or Canadian stock exchanges whose salesmen are trained and experienced in the securities business. Today, however, the majority of mutual fund shares are sold by salesmen employed by direct selling organizations.

119. Investor experience in mutual funds has beensatisfactory and there is much public confidence in this form of investment. The attitude has been augmented by Government recognition of mutual fund shares as an acceptable investment for deposit under Registered Retirement Savings Plans of individuals. It is essential that the true concept of the mutual fund be retained in such investment companies if the public is not to be subject to being misled. It may be necessary to introduce legislation at appropriate levels to insure that securities of investment companies were different concepts, regulations and objectives are not offered to the public under the guise of mutual funds.

120. Apprehension has been voiced in regard to the methods employed by some salesmen in marketing of standard dollar "withdrawal plans" as described in paragraphs 71 to 75 inclusive of this submission. The principle involved in these plans is recognized as being a sound and desirable one for those who wish to withdraw some capital gradually, possibly to supplement investment and other revenues. Persons have been persuaded to borrow money from a bank or elsewhere in order to purchase a sufficient number of mutual fund

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shares to start the plan. As will be appreciated, should the market decline, such a practice could result in a serious loss of capital and financial embarrassment. There are other records of persons liquidating life insurance policies for a similar purpose.

121. Some of the literature on "withdrawal plans" base their arguments entirely on past performance. It should be obligatory to state clearly that past performance is not necessarily a guide for the future and that such plans which pay out more than the income earned give a return on capital to the extent that the pay out exceeds net income. It should also be stated most distinctly in the sales literature that plans which guarantee monthly payments pay out so much from income and so much from capital.

122. It is appreciated that legislation cannot be substituted satisfactorily for education and experience coupled with voluntary influence in the direction of conduct. Accordingly, the announcement of the formation of a Canadian Association of Investment Companies would seem to be a most constructive development. While it is still in the formative stage, it must be said that an organization of a nature similar to the National Association of Investment Companies in the United States may be expected to make valuable contributions in the maintenance of high standards in the investment company industry as well as assisting both its members in the more technical aspects of the business and the Security Commissions of the various provinces in the introduction and

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administration of legislation pertaining to investment companies.

RECOMMENDATION

It is recommended to the Commission that consideration be given to the following suggestion:

123. That the Commission satisfy itself that there is sufficient protection under existing security acts for the adequate safeguard of shareholders of both open and closed end investment trusts, and if not to make recommendations for any additional regulatory legislation it may deem advisable.

MATERIAL DELETED

[illegible]

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RECOMMENDATION

It is recommended to the Commission that consideration be given to the following suggestion:

123. That the Commission satisfy itself that there is sufficient protection under existing security acts for the adequate safeguard of shareholders of both open and closed end investment trusts, and if not to make recommendations for any additional regulatory legislation it may deem advisable.

MATERIAL DELETED

MUTUAL FUNDS OPERATING IN CANADA

1. Canadian Incorporations investing essentially in Canada and owned primarily in Canada.

A. BALANCED FUNDS

Investments distributed in varying proportions in common and preferred stocks and corporate and government bonds.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Associate Investors Limited	$ 0.7	3/10 of 1%Q
Canadian Investment Fund	127.5	1/12 of 1%Q
Champion Mutual Fund of Canada	0.9	1/24 of 1%M
Commonwealth International Corporation	44.5	1/24 of 1%M
Corporate Investors	9.7	1/8 of 1%Q
Federated Growth Fund Ltd.	0.2	1/8 of 1%Q
Fonds Collectif "A" "B" "C"	3.2	N.R.
Investors Mutual of Canada	201.0	1/8 of 1%Q
North American Fund of Canada	6.9	1/8 of 1%Q
Radisson Fund	0.6	1/2 of 1%A
Savings and Investment Corp. Mutual Fund of Canada	4.6	1/8 of 1%Q
Timed Investment Fund	1.8	1/8 of 1%Q

B. COMMON STOCK FUNDS

Investments concentrated common stocks (85% or more) nearly all of which are of Canadian corporations.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
All-Canadian Compound Fund (x)		1/8 of 1%Q
All-Canadian Dividend Fund	$ 21.4	1/8 of 1%Q
Dominion Compound Fund	-	3/4 of 1%A
Dominion Dividend Fund	-	3/4 of 1%A
Grouped Income Shares Limited	8.4	1/8 of 1%Q
Investors Growth Fund of Canada Ltd.	46.5	1/8 of 1%Q
Mutual Accumulating Fund	26.0	4/10 of 1%A
Mutual Income Fund (xx)	-	4/10 of 1%A
United Accumulative Fund Ltd.	4.5	1/24 of 1%M
	106.8	

(x) These are recent incorporations.
(xx) Invests only in the shares of Mutual Accumulating Fund.
(y) Expressed as a percentage of net asset value at market.
(z) At market.

EXHIBIT "A"
Page 2

C. SPECIALTY FUNDS

Mutual Funds that either specialize in certain classes of Canadian securities or whose objectives or features differ from those of the average balanced mutual fund.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Commonwealth International Leverage Fund Ltd.	$ 4.8	1/2 of 1%A
(fund is permitted to borrow money)		
First Oil and Gas Fund Ltd.	5.3	1/8 of 1%Q
(invests in Canadian petroleum and related industries)		
Growth Oil and Gas	0.2	-
(invests in Canadian oil and gas industry)		
Mutual Bond Fund	1.6	1/10 of 1%Q
Supervised Executive Fund Ltd. (1955)	-	-
1956 Supervised Executive Fund Ltd.	-	-
1957 Supervised Executive Fund Ltd.	-	-
1958 Executive Fund of Canada Ltd.	-	-
	$11.9	

The 1955, 1956 & 1957 Funds invest only in shares of 1958 Executive Fund which in turn purchases the shares of Supervised Income, Supervised Growth and Supervised American Fund. Investments of 1958 Executive Fund at the end of 1960 were $813,061.

(z) At market.
(y) Expressed as a percentage of net asset value at market.

2. Mutual Funds incorporated in Canada and investing principally in Canadian stocks but whose shares are distributed largely outside of Canada and held chiefly by European investors.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Beaubran Corporation	$ 13.9	-
(French, Swiss and Belgian investors)		
Cana Fund Company Limited	20.1	1%A
(Swiss, Belgian and Dutch investors)		
Dominion Investments Ltd.	9.0	-
	43.0	

3. Canadian Incorporated Non-Resident Owned Mutual Funds registered under the United States Investment Company Act of 1940. These funds pay no dividends and reinvest all income.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Axe-Templeton Growth Fund of Canada Ltd.	$ 5.4	1/8 of 1%Q
Canada General Fund Ltd.	71.1	3/32 of 1%Q
Canadian International Growth Fund Ltd.	11.1	3/32 of 1%Q

EXHIBIT "A"
Page 3

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Investors Group Canadian Fund Ltd.	$119.9	1/8 of 1%Q
Keystone Fund of Canada Ltd.	15.3	3/4 of 1%A
Loomis-Sayles Fund of Canada Ltd.	16.5	5/8 of 1%A
New York Capital Fund, Ltd.	28.7	1/8 of 1%Q
Scudder Fund of Canada, Ltd.	49.9	5/32 of 1%Q
U.B.S. Fund of Canada Ltd.	3.5	5/32 of 1%Q
United Funds Canada Ltd.	15.9	1/2 of 1%A
	$337.3	

4. Canadian incorporated Mutual Funds held by Canadian investors with investments being made in the United States and Europe.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
American Growth Fund Limited	$ 12.4	1/2 of 1%A
Canadian Growth Fund (x)	-	3/16 of 1%Q
European Growth Fund Limited (x)	-	3/16 of 1%Q
Supervised American Fund	0.2	1/360 of 1%D
	$12.6	

(x) These are recent incorporations.
(y) Expressed as a percentage of net asset value at market.
(z) At market.

SUMMARY

	Number	1960 Net Asset Value (At Market) - millions -
1. Canadian Owned Funds		
A. Balanced	12	$ 401.6
B. Common Stock Funds	7	106.8
C. Specialty	5	11.9
		$ 520.3
2. Canadian incorporated - foreign owned funds	3	43.0
3. Canadian NRO Funds registered in U.S.A.	10	337.3
		$ 900.6
4. Canadian owned Funds for foreign investment	4	$ 12.6

EXHIBIT "B"

INCOME TAX ACT
R.S.C. 1952 c. 148 with amendments
Sections 69 and 70

INVESTMENT COMPANIES

69. (1) The tax payable under this part by a corporation for a taxation year when it was an investment company is an amount equal to 18 per cent of its taxable income for the year.

(2) In this Act, "investment company" means a corporation that, in respect of the taxation year in respect of which the expression is being applied, complied with the following conditions:

(a) at least 80 per cent of its property was, throughout the year, shares, bonds, marketable securities or cash.

(b) not less than 95 per cent of its income for the year was derived from investments mentioned in paragraph (a)

*(ba) not less than 85 per cent of its gross revenue for the year was from sources in Canada.

**(bb) not more than 25 per cent of its gross revenue for the year was from interest.

(c) At no time in the year did more than 10 per cent of its property consist of shares, bonds or securities of any one corporation or debtor other than Her Majesty in right of Canada or of

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a province or a Canadian municipality.

(d) at no time in the year was the number of shareholders of the corporation less than 50, none of whom at any time in the year held more than 25 per cent of the shares of the capital stock of the corporation, and

(e) an amount not less than 85 per cent of its taxable income plus exempt income for the year (other than dividends or interests received in the form of shares, bonds or other securities that have not been sold before the end of the taxation year) minus

i. 21 per cent of its taxable income for the year and

ii. taxes paid in the year to other governments, was distributed to the shareholders before the end of the year.

(f) Repealed. 1955, c. 54, s.14(3).

(g) Repealed. 1957, c. 29, s.15.

* NOTE: Applicable to taxation years commencing in 1961 and subsequent taxation years, except that:

(a) in the case of a corporation less than 85 per cent but not less than 75 per cent of the gross revenue of which for its taxation year commencing in 1960

a province or a Canadian municipality.

(d) at no time in the year was the number of shareholders of the corporation less than 50, none of whom at any time in the year held more than 25 per cent of the shares of the capital stock of the corporation, and

(e) an amount not less than 85 per cent of its taxable income plus exempt income for the year (other than dividends or interests received in the form of shares, bonds or other securities that have not been sold before the end of the taxation year) minus

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* NOTE: Applicable to taxation years commencing in 1961 and subsequent taxation years, except that:

(a) in the case of a corporation less than 85 per cent but not less than 75 per cent of the gross revenue of which for its taxation year commencing in 1960

was from sources in Canada, the expression "85 per cent" in paragraph (ba) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960 - 61 shall, in its application to the taxation years of the corporation commencing in 1961 and 1962 be read as "75 per cent".

(b) in the case of a corporation less than 75 per cent of the gross revenue of which for its taxation year commencing in 1960 was from sources in Canada, the expression "85 per cent" in paragraph (ba) of subsection (2) of section 69 an enacted by section 7 of chapter 17 of the Statutes of 1960 -- 61 shall, in its application to the taxation year of the corporation commencing in 1961 be read as "60 per cent" and in its application to the taxation year of the corporation commencing in 1962, be read as "75 per cent":

(c) in the case of a corporation more than 25 per cent but not more than 30 per cent of the gross revenue of which for its taxation year commencing in 1960 was from interest, the expression "25 per cent" in paragraph (bb) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes

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(c) in the case of a corporation more than 25 per cent but not more than 30 per cent of the gross revenue of which for its taxation year commencing in 1960 was from interest, the expression "25 per cent" in paragraph (bb) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes

of 1960-61 shall, in its application to the taxation years of the corporation commencing in 1961 and 1962, be read as "30 per cent"; and

(d) in the case of a corporation more than 30 per cent of the gross revenue of which for its taxation year commencing 1960 was from interest, the expression "25 per cent" in paragraph (bb) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960 -- 61 shall, in its application to the taxation year of the corporation commencing in 1961, be read as "40 per cent" and in its application to the taxation year of the corporation commencing in 1962, be read as "30 per cent". (1960-61, c. 17.s.7 (2).)

complied with the following conditions:

(a) at least 95 per cent of the aggregate value of its issued shares and all of its bonds, debentures and other funded indebtedness were

i. beneficially owned by non-resident persons,

ii. owned by trustees for the benefit of non-resident persons or their unborn issue, or

iii. owned by a corporation, whether incorporated in Canada or elsewhere, at least 95 per cent of the aggregate value of the issued shares of which and all of the bonds, debentures and other funded indebtedness of which where beneficially owned by non-resident persons or owned by trustees for the benefit of non-resident persons or their unborn issue or by several such corporations;

(b) its income was derived from

i. ownership of or trading or dealing in bonds, shares, debentures, mortgages, hypothecs, bills, notes or any interest therein,

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(b) its income was derived from

i. ownership of or trading or dealing in bonds, shares, debentures, mortgages, hypothecs, bills, notes or any interest therein,

ii. lending money with or without security.

iii. rents, hire of chattels, charterparty fees or remunerations, annuities, royalties, interest or dividends, or

iv. estates or trusts;

(ba) not more than 10 per cent of its gross revenue was derived from rents, hire of chattels, charterparty fees or charterparty remunerations.

(c) its principal business was not

i. the making of loans, or

ii. trading or dealing in mortgages, hypothecs, bills, notes or other similar property or any interest therein;

(d) it has, not later than 90 days after the commencement of the taxation year, elected in prescribed manner to be taxed under this section; and

(e) it has not, before the taxation year, revoked in a prescribed manner the elections so made by it. 1948, c.52, s.63; 1949 (2nd Sess.), c.25, s.32; 1952, c.29, s.20.

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iii. rents, hire of chattels, charterparty fees or remunerations, annuities, royalties, interest or dividends, or

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(e) it has not, before the taxation year, revoked in a prescribed manner the elections so made by it. 1948, c.52, s.63; 1949 (2nd sess.), c.25, s.32; 1952, c.29, s.20.

K -

AN ANALYSIS OF THE FIRST FIFTEEN COMMON STOCKS HAVING BOTH A BID AND ASKED PRICE IN THE MONTREAL STOCK EXCHANGE OFFICIAL DAILY NEWS AS OF THE CLOSE OF BUSINESS SHOWING THE DIFFERENCE BETWEEN THE TOTAL COST OF SHARES PURCHASED AT THE ASKED PRICES, AND THE PROCEEDS WHEN THEY ARE SOLD AT THE BID PRICES

As at May 31, 1960

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh	Commission	Net Proceeds
itibi	$41-1/4	$0.40	240.0	$10,000	$40-3/4	$0.40	$ 9,684
adia Atl. Sugar	10-1/4	0.25	952.3	10,000	9-3/4	0.20	9,094
ew Surpass Shoe	19	0.30	518.1	10,000	18	0.30	9,170
oma Steel	35	0.35	282.8	10,000	34-3/4	0.35	9,728
minium Ltd.	32-3/8	0.35	305.5	10,000	32-1/8	0.35	9,707
us Corp.	30-1/8	0.35	328.1	10,000	30	0.35	9,728
estos Corp.	25	0.35	394.4	10,000	24-1/2	0.30	9,544
as Steels	22	0.30	448.4	10,000	20-1/8	0.30	9,058
k of Montreal	51	0.40	194.5	10,000	50-1/2	0.40	9,744
of Nova Scotia	62-3/4	0.45	158.2	10,000	62-1/4	0.45	9,777
q.Cdn.Nationale	51	0.40	194.5	10,000	50-1/2	0.40	9,744
q. Provinciale	35	0.35	282.8	10,000	33-3/4	0.35	9,446
hurst P.& P."A"	44	0.40	225.2	10,000	43-1/4	0.40	9,650
hurst P.& P."B"	33	0.35	299.8	10,000	32	0.35	9,489
l Telephone	45	0.40	220.2	10,000	44-3/4	0.40	9,766
				$150,000			$143,330

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	143,330
"Spread"	$ 6,670
Percentage "Spread"	4.45%

As at April 29, 1960

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh	Commission	Net Proceeds
tibi	$38-1/4	$0.35	259.1	$10,000	$38	$0.35	$ 9,755
ew Surpass Shoe	19-1/4	0.30	511.5	10,000	18-5/8	0.30	9,373
oma Steel	33-3/4	0.35	293.25	10,000	33	0.35	9,575
minium Ltd.	28-3/4	0.35	343.6	10,000	28-5/8	0.35	9,715
us Corp.	32	0.35	309.1	10,000	28-1/8	0.35	8,585
estos Corp.	26	0.35	379.5	10,000	24-1/2	0.30	9,184
as Steels	23-1/2	0.30	420.1	10,000	23	0.30	9,536
k of Montreal	49-3/4	0.40	199.4	10,000	49-1/4	0.40	9,741
of Nova Scotia	60	0.45	165.4	10,000	59-3/4	0.40	9,816
q.Cdn.Nationale	50-1/2	0.40	196.4	10,000	49-1/2	0.40	9,643
q. Provinciale	36	0.35	275.1	10,000	35	0.35	9,532
hurst P.& P."A"	45	0.40	220.2	10,000	44	0.40	9,601
hurst P.& P."B"	32-1/2	0.35	304.4	10,000	31	0.35	9,330
l Telephone	44-5/8	0.40	222.0	10,000	44-1/2	0.40	9,790
ater Paper	8	0.20	1,219.5	10,000	7-1/2	0.20	8,902
				$150,000			$142,079

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	142,079
"Spread"	$ 7,921
Percentage "Spread"	5.28%

AN ANALYSIS OF THE FIRST FIFTEEN COMMON STOCKS HAVING BOTH A BID AND ASKED PRICE IN THE MONTREAL STOCK EXCHANGE OFFICIAL DAILY NEWS AS OF THE CLOSE OF BUSINESS SHOWING THE DIFFERENCE BETWEEN THE TOTAL COST OF SHARES PURCHASED AT THE ASKED PRICES, AND THE PROCEEDS WHEN THEY ARE SOLD AT THE BID PRICES

As at June 21, 1957

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh.	Commission	Net Proceeds
new Surpass Shoe	$ 8	$0.20	1,234.5	$10,000	$ 7-3/4	$0.20	$ 9,320
uminum Ltd.	44-1/2	0.40	222.7	10,000	44-1/4	0.40	9,765
gus Corp.	17	0.30	578.0	10,000	16-1/2	0.30	9,364
bestos Corp.	31-1/2	0.35	313.9	10,000	31	0.35	9,621
las Steels	25-3/4	0.35	383.1	10,000	25	0.35	9,712
nk of Montreal	47-3/8	0.40	209.3	10,000	47	0.40	9,753
ll Telephone	40-7/8	0.40	242.2	10,000	40-3/4	0.40	9,773
azilian Traction	9-3/4	0.20	1,005.0	10,000	9-1/2	0.20	9,347
A. Oil	53-1/4	0.40	186.3	10,000	52-1/4	0.40	9,660
C. Power	51-1/2	0.40	192.6	10,000	51	0.40	9,746
C. Telephone	44	0.40	225.2	10,000	43-1/2	0.40	9,706
uck Mills "A"	7	0.15	1,398.6	10,000	6-1/2	0.15	8,881
uck Mills "B"	2-3/4	0.06	3,558.7	10,000	2	0.06	6,904
ilding Products	35	0.35	282.8	10,000	33	0.35	9,233
lolo Gold Dredging	4.00	0.10	2,439.0	10,000	3.75	0.08	8,951
				$150,000			$139,736

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	139,736
"Spread"	$ 10,264
Percentage "Spread"	6.84%

As at November 2, 1956

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh.	Commission	Net Proceeds
itibi	$34-5/8	$0.35	285.9	$10,000	$34-1/2	$0.35	$ 9,763
adia Atl. Sugar	8-5/8	0.20	1,133.2	10,000	8-1/2	0.20	9,406
goma Steel	111	0.60	89.6	10,000	110	0.60	9,802
uminum Ltd.	121	0.60	82.25	10,000	119-3/4	0.60	9,800
gus Corp.	18-1/2	0.30	531.9	10,000	17-3/4	0.30	9,282
bestos Corp.	37	0.35	267.75	10,000	35-1/2	0.35	9,411
las Steels	29-1/2	0.35	335.1	10,000	29-1/4	0.35	9,684
nk of Montreal	50	0.40	198.5	10,000	49-1/2	0.40	9,746
.of Nova Scotia	55-1/2	0.40	178.9	10,000	55	0.40	9,768
nq.Cdn.Nationale	40-1/2	0.40	244.5	10,000	40	0.40	9,682
ll Telephone	45-7/8	0.40	216.1	10,000	45-5/8	0.40	9,773
azilian Traction	7-1/2	0.20	1,298.7	10,000	7-3/8	0.15	9,383
A. Bank Note	35	0.35	282.9	10,000	30	0.35	8,388
A. Oil Co.	46	0.40	215.6	10,000	45-3/4	0.40	9,777
C. Forest Prod.	13-1/4	0.25	740.75	10,000	13	0.25	9,445
				$150,000			$143,112

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	143,112
"Spread"	$ 6,888
Percentage "Spread"	4.59%

EXHIBIT "D"

REPRESENTATIVE CANADIAN MUTUAL FUNDS

TOTAL NET ASSETS AT MARKET

	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951	1950
						$000,000						
1. C.I.F.	151.2	127.5	126.6	120.2	83.8	86.7	79.3	63.8	54.8	45.7	44.6	39.3
2. Common Int.	61.6	44.4	35.4	20.1	10.6	10.8	12.2	10.7	8.5	9.1	10.2	7.8
3. Mut. Accum. (a)	38.7	27.1	24.3	18.4	13.4	14.7	11.1	5.3	2.3	1.3	0.7	0.4
4. Inv. Mut.	277.3	201.0	189.6	162.3	122.7	115.5	82.0	45.6	28.4	19.1	11.5	2.5
5. All-Cdn. Divd. (b)	26.7	21.4	24.7	18.6	8.0	7.3	4.9	1.1	-	-	-	-
TOTAL	555.5	420.4	400.6	339.6	238.5	235.0	189.5	126.5	85.0	75.2	67.0	50.0

(a) Includes Mutual Income Fund.
(b) Includes All-Canadian Compound Fund.

1. Canadian Investment Fund Ltd.
2. Commonwealth International Corporation Ltd.
3. Mutual Accumulating Fund.
4. Investors Mutual of Canada Ltd.
5. All-Canadian Dividend Fund.

STATISTICAL SUMMARY OF OPEN-END
UNITED STATES
INVESTMENT COMPANIES (MUTUAL FUNDS)

Year	No. of Companies Reporting	Total (1) Net Assets ($000)	Share-holder (1) Accts. In Force	Shares Sold ($000)	Shares Redeemed ($000)	% Red. to Sales
1940	68	447,959	295,056	N. A.	N. A.	-
1941	68	401,611	293,251	53,312	45,024	84.4
1942	68	468,580	312,609	73,140	25,440	34.8
1943	68	653,653	341,435	116,062	51,221	44.1
1944	68	882,191	421,675	169,228	70,815	41.8
1945	73	1,284,185	497,875	292,359	109,978	37.6
1946	74	1,311,108	580,221	370,353	143,612	38.8
1947	80	1,409,165	672,543	266,924	88,732	33.2
1948	87	1,505,762	722,118	273,787	127,171	46.4
1949	91	1,973,547	842,198	385,526	107,587	27.9
1950	98	2,530,563	938,651	518,811	280,728	54.1
1951	103	3,129,629	1,110,432	674,610	321,550	47.7
1952	110	3,931,407	1,359,000	782,902	196,022	25.0
1953	110	4,146,061	1,537,250	672,005	238,778	35.5
1954	115	6,109,390	1,703,846	862,817	399,702	46.3
1955	125	7,837,524	2,085,325	1,207,458	442,550	36.6
1956	135	9,046,431	2,580,049	1,346,738	432,750	32.1
1957	143	8,714,143	3,110,392	1,390,557	405,716	29.2
1958	151	13,242,388	3,630,096	1,619,768	511,263	31.6
1959	155	15,817,962	4,276,077	2,279,982	785,627	34.4
1960	161	17,025,684	4,897,600	2,097,246	841,815	40.1

(1) At year end.

Source Material: National Association of Investment Companies.

EIGHT LARGEST U.S. DOMESTIC OPEN-END FUNDS

		Net Assets at Market						Shares Outstanding(x)					
	*	1960	1959	1958	1957	1956	1955	1960	1959	1958	1957	1956	1955
		millions						millions					
1. Affiliated Fund	1934	586	575	478	346	358	336	82.9	76.1	68.8	63.1	60.1	55.6
2. Fundamental Investors	1932	591	599	515	335	372	320	66.2	62.0	56.4	50.1	45.0	40.9
3. Investors Mutual	1940	1,505	1,413	1,217	997	954	847	150.4	138.6	125.3	116.6	104.8	93.2
4. Investors Stock Fund	1945	638	559	380	233	205	133	41.6	33.9	24.9	19.9	15.4	10.9
5. Massachusetts Invest. Trust	1924	1,508	1,558	1,432	976	1,098	957	114.5	111.8	107.3	100.5	94.5	87.3
6. National Securities Series	1940	440	467	388	276	284	249	76.2	70.4	65.4	54.3	41.7	36.4
7. United Funds, Inc.	1940	863	748	559	342	349	273	73.4	62.2	50.5	40.7	33.1	27.3
8. Wellington Fund	1928	1,087	1,017	858	604	579	497	81.0	71.9	61.8	52.3	44.6	37.2
		7,218	6,936	5,827	4,109	4,199	3,612	686.2	626.9	560.4	497.5	439.2	388.8

(x) Adjusted for stock splits.
* Date of Incorporation.

ILLUSTRATION OF WITHDRAWAL PLAN
1950 - 1961
(discussed in paras. 71-75)

ELEVEN YEAR (PLUS 10 MONTHS) SUMMARY OF $25,000
INVESTED IN INVESTORS MUTUAL OF CANADA LTD.* ON MARCH 1, 1950
AND MONTHLY REDEMPTIONS OF $200.00 COMMENCING
ONE YEAR AFTER ORIGINAL INVESTMENT

ALL DIVIDENDS RE-INVESTED

March 1, 1950 - Original Investment (4,672,897 shares @ $5.35)	$25,000.00
Total Dividends Re-invested (11 years, 10 months)	$14,306.20
Total Redemptions (130 x $200) (10 years, 10 months)	$26,000.00
December 31, 1961 - Value of Remaining Shares (3,371,649 x $13,356)	$45,031.74

* Extract from Company's literature which also carries the following statement:

"WHILE THE FOREGOING FIGURES ARE BASED ON ACTUAL PAST PERFORMANCE THEY CANNOT BE CONSTRUED AS AN INDICATION OR GUARANTEE OF FUTURE PERFORMANCE".

SUMMARY OF ACCOUNT AS AT DECEMBER 31 OF EACH YEAR

March 1, 1950 - Original Investment (4,672,897 shares @ $5.35) $25,000.00

Dec. 31,	Number of Shares	Price per Share	Value
1950	4,783.148	5.750	27,503.10
1951	4,679.923	6.490	30,372.70
1952	4,506.600	6.431	28,981.94
1953	4,326.335	6.395	27,666.91
1954	4,159.718	8.379	34,854.28
1955	4,029.292	9.710	39,124.43
1956	3,912.979	10.112	39,568.04
1957	3,798.411	8.950	33,995.78
1958	3,675.277	11.117	40,858.05
1959	3,568.972	11.219	40.040.30
1960	3,463.626	11.368	39,374.50
1961	3,371.649	13.356	45,031.74

CANADIAN INVESTMENT FUND, LTD.

Year	No. Shares Issued	No. Shares Redeemed	No. Shares Outstanding	Total Net Assets	No. of Share-holders
1933	242,004	NIL	242,004	733,771	N.A.
1934	503,929	NIL	745,933	2,473,785	N.A.
1935	248,749	86,720	907,962	3,593,667	N.A.
1936	299,170	66,800	1,140,332	5,496,068	N.A.
1937	507,106	NIL	1,647,438	5,819,789	3,205
1938	509,204	1,000	2,155,642	8,990,290	4,351
1939	329,242	95,749	2,389,135	10,002,339	4,772
1940	103,021	217,410	2,274,746	7,829,966	4,784
1941	114,757	97,790	2,291,713	7,164,996	4,815
1942	200,580	18,982	2,473,311	8,255,541	4,952
1943	87,862	27,638	2,533,535	9,370,107	5,061
1944	166,135	24,949	2,674,721	10,993,437	5,216
1945	49,717	167,299	2,557,139	12,982,480	5,126
1946	129,497	166,318	2,520,318	11,862,364	5,141
1947	228,705	25,192	2,723,831	12,554,079	5,781
1948	411,920	32,450	3,013,301	14,452,824	6,325
1949	1,988,451	13,732	5,078,020	25,318,567	10,398
1950	1,672,608	13,533	6,731,095	39,277,667	14,133
1951	296,070	90,754	6,942,411	44,561,661	15,059
1952	295,178	54,269	7,183,320	45,718,056	16,171
1953	496,462	22,821	7,656,961	45,803,482	17,005
1954	817,645	340,036	8,134,570	63,843,602	17,636
1955	704,019	65,106	8,773,483	79,335,996	18,260
1956	902,667	45,592	9,630,558	86,720,977	19,409
1957	1,285,462	110,736	10,805,284	83,821,628	20,706
1958	2,265,651	58,952	13,011,983	120,195,297	23,651
1959	1,191,255	231,696	13,971,542	126,632,665	24,687
1960	754,820	339,441	14,386,921	127,466,674	24,786
1961	554,841	919,500	14,022,262	151,207,107	23,423

INVESTORS MUTUAL OF CANADA LTD.

Fiscal Year Ended Oct. 31	Shares Issued	Shares Redeemed	Shares Outstanding	Number of Share-holders
1950	465,957.590	602.720	465,354.870	1,801
1951	1,368,639.280	50,579.620	1,783,414.530	6,086
1952	1,399,583.380	108,610.560	3,074,387.350	9,862
1953	1,644,376.210	183,940.280	4,534,823.280	13,358
1954	1,859,376.770	389,232.660	6,004,967.390	16,187
1955	3,149,463.260	373,193.260	8,781,237.390	23,196
1956	3,514,894.800	585,529.436	11,710,402.754	32,585
1957	3,096,183.693	929,231.217	13,877,355.230	40,168
1958	2,361,522.447	1,081,274.226	15,157,603.451	41,768
1959	3,359,443.735	1,192,004.981	17,325,042.205	44,267
1960	2,949,714.776	1,344,969.885	18,929,787.096	45,409
1961	4,059,905.075	1,422,744.234	21,566,947.937	51,700

A.649

EXHIBIT "J"

CANADIAN INCORPORATED N.R.O. MUTUAL FUNDS

PRIMARILY OWNED IN U.S.A.

	*	Net Value Assets at Market						Total Shares Outstanding						
		1960	1959	1958	1957	1956	1955	1960	1959	1958	1957	1956	1955	
		$ millions						$ millions						
Axe Templeton Growth	1954	5.4	4.1	3.5	3.0	5.8	-	.62	.58	.55	.61	1.0	-	(x)
Canada General Fund	1954	71.1	89.1	91.1	73.6	65.6	54.6	5.4	6.4	6.5	6.6	5.6	5.5	
Cdn. Int. Growth	1956	11.1	10.2	6.5	4.5	-	-	1.1	1.0	.78	.73	-	-	
Investors Group Cdn.	1954	111.9	144.2	167.4	120.3	107.9	51.6	21.1	25.7	29.3	27.9	19.1	10.2	
Keystone Fund of Cda.	1954	15.3	16.3	14.6	12.6	8.8	6.4	1.1	1.3	1.2	1.2	.88	.71	
N.Y. Capital Fund	1954	28.7	31.1	28.1	23.0	27.8	27.5	2.1	2.4	2.3	2.5	2.6	2.9	(x)
Scudder Fund Canada	1953	49.9	55.4	59.7	45.0	49.7	50.1	4.2	4.7	5.0	4.7	4.8	5.0	(x)
United Funds Canada	1954	15.9	18.5	23.3	19.1	20.7	14.4	.97	1.2	1.5	1.3	1.3	.99	
		$309	$369	$394	$301	$286	$205	36.6	43.3	47.1	45.5	35.3	25.3	

* Date of incorporation.
(x) Adjusted for stock splits.

Loomis-Sayles Fund of Canada Ltd. and U.B.S. Fund of Canada Ltd. have been omitted from the above tabulation because they are recent incorporations and would distort the overall figures.

APPENDIX L

FINANCING OF SMALL BUSINESSES

CONTENTS

APPENDIX L

FINANCING OF SMALL BUSINESSES

CONTENTS

FINDINGS OF THE COMMITTEE INVESTIGATING THE FINANCING OF SMALL BUSINESSES FOR THE INVESTMENT DEALERS' ASSOCIATION'S BRIEF TO THE ROYAL COMMISSION

DEFINITION

1) The sponsors of a worthwhile project requiring financing of $500,000 or more can generally make satisfactory arrangements for either a debt or equity issue with an established investment dealer. For the purposes of this study therefore, a small business is defined as one requiring to raise less than $500,000 regardless of the size of the business itself. Generally speaking a large business will not be looking for less than $500,000 through other than banking or regular mortgage channels.

WAYS OPEN TO A SMALL BUSINESS IN SECURING FINANCING

Private Placement

2) Friends and relatives of the entrepreneur who may take shares or bonused notes. This is the common approach for the very small enterprise and for the fortunate few having the right contacts. Private placements of both debt and equity can sometimes be arranged through investment dealers who will place the issue with a small group of clients or with one or two institutions selected from among the few willing to participate in financing of this type. Occasionally the members of the dealer firm will themselves participate if the issue particularly appeals to them or if it is a piece of interim financing before the company is ready for public offering.

3) Unfortunately, the record shows that few

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3) Unfortunately, the record shows that few

companies can qualify for this type of financing. In a recent survey made for the purposes of this study, 47 of the 103 Investment Dealers' Association members reporting had offered a total of 217 small business issues during the past two years. Of this number only 18 were for private placement.

Industrial Development Bank

4) This is Canada's best answer to date to the problem under study. At the end of its latest fiscal year the Bank had 1,364 loans outstanding for a total amount of $71,196,000 indicating an average outstanding balance of $52,000 per loan. Loans are only granted on the security of fixed assets.

5) In connection with the I.D.B. operations the following criticisms were encountered:

i. Services too slow

ii. Costs, which sometimes include bonus shares, may be too high as evidenced by the fact that reserves of some $18 million have been accumulated by the Bank.

iii. The lien on assets is often too tight or too wide to permit secondary financing.

iv. The required ratio of equity to the proposed loan may be too high.

v. The small business is often obliged to accept fixed obligations when equity capital may have been the propre route.

vi. Repayment requirements are often too heavy in the early years.

The Committee did not consider it incumbent upon it to

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investigate these criticisms and in general has felt that the operations of the I.D.B. were satisfactory.

Chartered Banks

6) This should be the first stop for the business requiring short term loans for such purposes as carrying inventory, accounts receivable, etc. This aspect is outside the scope of this study but it should be noted that inexperienced managements sometimes overlook this source of funds. Of particular importance are the bank loans available under the terms of the Small Business Loans Act. Manufacturing, wholesale trade, retail trade and service businesses grossing less than $250,000 per year may borrow up to $25,000 for certain kinds of equipment, fixed assets or improvements to fixed assets. The loan may cover up to 80 per cent of the cost (90 per cent on improvements to premises). The Government guarantees the lending bank to the extent of 10 per cent of the aggregate of such loans granted by it prior to December 31st, 1963, but it is up to the bank to set its own standards as to security, credit risks, etc. It is probably because of this latter fact that loans granted under the terms of this Act have not been as numerous as originally expected.

7) The recent Throne Speech indicated that the current session of parliament would be asked to increase the size of such loans to $50,000 and extend eligibility to businesses with an annual gross revenue of $750,000. This move is strongly endorsed by this Committee. However, it is felt that an increase in the government guarantee to, say, 25 per cent of the aggregate of all

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such loans granted by a lending bank and an extension of the 1963 deadline would widen the effectiveness of the Act.

Public Distribution

8) A canvass of a representative group of lending institutions confirmed their reluctance to participate in issues of small businesses. Almost without exception they avoid participation in small stock issues and their investments in small bond issues are very selective and limited. The investment dealer is accustomed to looking to these major pools of money for support in larger issues but the underwriter of smaller issues must rely on the retail buyer. This greatly increases the cost to the issuing company.

9) Large investment dealer firms with wide distribution power cannot afford to handle small issues. However, the records show that if the issue has sufficient merit it is probable that an investment dealer can be found to take it on. As previously mentioned 47 I.D.A. members reported handling 217 such issues in the last two years. $200,000 appears to be the lower limit of practicability for public distribution although smaller issues are occasionally offered. Below this figure the costs are out of proportion and one or more of the major small business problems generally apply. These are

i. lack of management experience

ii. lack of management depth

iii. inability to withstand a recession.

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v. reluctance to accept partners on equal or near equal basis

vi. insufficient amount at risk by the owner or promoter.

10. The question of marketability is most difficult and is the objection most frequently cited by institutions and private investors alike. It strikes hardest against equity issues for obvious reasons and applies even in the case of successful operations.

<u>Other Sources of Funds</u>

11. There exist a few public and private organizations willing to supply funds under certain conditions. Certain Municipal Industrial Commissions make funds available to small as well as large businesses by way of grants of land, commutation of taxes, etc. In Nova Scotia, the provincial government corporation, Industrial Estates Limited, will assist in financing the acquisition of land and buildings. Its existence has proved helpful on many occasions and has undoubtedly benefited the province. However, it does nothing to solve the equity problem. Certain private corporations are prepared to help with equity but they are ultra selective and they have only limited funds. It is felt that in general they are inclined to end up with too large a share of the common stock. Moreover such organizations are often unknown to the small management seeking financing. The factoring and acceptance companies are not a source of long term money.

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METHODS IN BRITAIN AND THE U.S.

12. The Industrial and Commercial Finance Corporation was set up in 1946 by the Bank of England, the London clearing banks and the Scottish banks, to provide credit for industrial and commercial businesses or enterprises in Great Britain, particularly in cases where the existing facilities provided by banking institutions and underwriters and stock exchanges were not readily or easily available. This Corporation, as in the case of the small business investment companies, was thus intended to supplement but not supersede the activities of other lenders and other financial institutions. The Industrial and Commercial Finance Corporation considers that requirements of credit for small sums (under Ь 5,000) can be made by the banks and that larger capital requirements (over Ь 200,000) can be satisfied by the new issue market and other credit institutions and the Corporation is precluded from taking up either the whole or part of any loan of more than Ь200,000. The Corporation's nominal capital was fixed at Ь15,000,000 and all the shares are to be held by the banks which set up the Corporation which, in addition, may borrow from the shareholding banks up to twice the amount of its capital. It is not permitted to raise money from any other source than from the shareholding banks. It would seem that the shareholding banks in Great Britain now agree that the Industrial and Commercial Finance Corporation has earned itself a permanent place in the monetary system.

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Administration, set up by the United States Congress in 1958, has contributed in a very major fashion in providing funds for small business ventures. Congress, after completion of a study by the Federal Reserve which established that long term funds were not easily available, passed a law authorizing the Small Business Administration to license, supervise and, in certain cases, help finance small business investment companies which would serve as sources of equity capital and long term loans to small business. While there have always been individuals and businesses ready to invest in promising situations, the Small Business Administration served to institutionalize the procurement of venture capital for small business and make the rules for such procurement open for public scrutiny, very much as investment dealers and major stock exchanges have done for bigger business both here and in the United States. The success of the program established in the Small Business Administration is indicated by the fact that there are in existence some 425 small business investment companies with capital available for investment in small business amounting to $500,000,000. In addition to that sum, these small business investment companies may borrow from the S.B.A. 50 per cent of that figure (subject to a limit of $4,000,000 each). This greatly increases their available funds and they may still borrow from outside sources. It might be noted that amongst the principal stock holders of many of these small business investment companies are more than 125 American banks, including some of the largest in the

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<u>CONCLUSIONS AND RECOMMENDATIONS</u>

15. (Ia) If a small business has merit and mortgageable assets a perservering and informed management can probably arrange dor debt financing through direct mortgage to a lending institutions, the Industrial Development Bank, the Small Business Loans Act or, if not too small, public and occasionally private Placement through an investment dealer.

(Ib) All of these facilities tend to drive companies into borrowing when permanent equity capital may be the proper route for them.

(II) The largest pools of money, the banks and insurance companies, are of little help in long term financing for small businesses even those having mortgageable assets and a long earnings record.

(III) The majority of investment dealers can do little for the business requiring less than $200,000 and only certain firms will handle anything under $500,000. Lack of marketability makes public equity financing particularly difficult.

(IV) The low corporation tax rate applicable

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to the first $35,000 of earnings is particularly helpful to small businesses as it enables them to generate more funds internally and also makes them more attractive to potential investors.

(V) The operations of the Small Business Administration in the United States are worthy of careful study and consideration should be given to establishing similar legislation here which would result in small business investment companies having similar government support.

(VI) Consideration should be given to encouraging the participation of insurance companies, mutual funds and possibly the banks in equity investments in small business investment companies. These large lending investment institutions control tremendous funds practically none of which are at present available either for risk capital or for small business equity investment. If, for example, the life insurance companies were to apply for an amount equal to 1/4 of 1 per cent of their portfolios to such investments, the proposed small business investment companies would have some $20 million of equity capital for their initial operations.

Representatives of certain I.D.A. member firms, with whom this committee consulted, did not agree that these aims should be achieved by legislation. The committee believes that better results could be obtained through encouraging these institutions to attack this problem voluntarily using the methods best suited to their individual circumstances and responsibilities.

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(VII) To encourage public participation in the proposed small business investment companies special tax advantages should be considered. One such could be an increase in the present income tax credit from 20 per cent to 30 per cent for dividends from small business investment companies' shares.

(VIII) Many small entrepreneurs are reluctant to give up much equity. Consideration could be given by appropriate government authority to allow a tax credit, similar to that now made on dividends of Canadian companies, to corporate lenders who may loan money to small businesses or to individual lenders except when they are the owner of the business.

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APPENDIX M

NON-RESIDENT INVESTMENT

Contents

Introduction

1. The following brief outlines the role of non-resident investment in Canada, with particular emphasis on fixed monetary claims represented by debt. The factors which determine the composition and extent of purchases of debt securities by non-residents are outlined below:

General

2. Periods of great economic expansion in Canada have, in the past, brought foreign capital to this country. The most recent period of expansion, namely between 1946 - 1960, is the one we are particularly interested in, and is by far the greatest. Gross national product rose from $11,850,000,000 in 1946 to $34,857,000,000 in 1959. Foreign long term investment in Canada rose from $7.1 billion in 1945 to $20.6 billion in 1959.

3. While in earlier periods of expansion, capital came mostly from England and France, the United States has recently been by far the largest supplier of capital. In 1959 the total value of United States investments in Canada was divided as follows:

Direct Investment	$ 9,850 million
Government and Municipal	2,767 million
Ohter Portfolio	2,238 million
Miscellaneous	870 million
	$15,725 million

This compares with the total of $20.6 billion from all countries.

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Direct Investment	$ 9,850 million
Government and Municipal	2,767 million
Other Portfolio	2,738 million
Miscellaneous	370 million
	$15,725 million

This compares with the total of $20.6 billion from all countries.

4. The growth of gross national product,

gross capital formation and the extent to which this was financed from domestic and foreign resources is shown in Exhibit 1, appended hereto.

5. From 1946 to 1949 Canada raised at home sufficient capital to finance its gross capital formation and, in fact, was a net exporter of capital. In the subsequent years, foreign capital was imported in extremely large amounts and in 1959 over 29 per cent of the gross capital formation was financed by the use of foreign resources. In 1960 and 1961 this capital inflow was substantially reduced.

6. Foreign capital has come to Canada in two main forms:

(a) Direct Investment

(b) Security or Portfolio Investment

Direct Investment

7. Direct investment involves the establishment of branch manufacturing plants by foreign companies, foreign purchase of established companies, direct foreign development of natural resources and construction of buildings of all kinds, etc. This particular kind of investment is almost entirely outside the field of the investment dealer but the amount of new capital invested in Canada in this way accounts for approximately two-thirds of all foreign investments. In many instances this capital has been accompanied by new techniques and has, consequently, developed resources in Canada that otherwise would never have been developed.

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9. Canadian commercial policy has historically manifested itself in tariffs designed to provide a measure of protection for secondary manufacturing. This protection has encouraged United States companies to "jump" Canadian tariff walls and establish branch plant operations in Canada. In recent years, Canadian manufacturing has suffered from a large number of small firms operating in a limited market, resulting in excess capacity and high unit costs.

10. Exhibit 2 shows the amount of direct investment each year from 1946 to 1961.

<u>Security or Portfolio Investments</u>

11. The extent of sales of Canadian securities to non-residents is shown in Exhibit 2, and Exhibit 4.

12. The flow of capital to Canada through security or portfolio investments did not just happen. The investment dealer, with his knowledge of the huge demand for capital went out to foreign countries and sold investment opportunities in Canada to foreigners. Branches were established in foreign countries, mainly New York City and London, England and dealers directly contacted foreign institutional accounts. The investment dealer was so successful in selling Canada that Canadian portfolio securities became an established medium of investment.

13. The extent to which Canada benefited from this inflow of capital can be visualized to some degree by reviewing some of the major projects that were, at least partly, made possible by these funds:

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(a) the construction of all the large pipelines, including gathering systems, to transport oil and gas from the mid-western fields to the eastern and Pacific markets,

(b) the development of iron mines in Quebec and Labrador and the construction of railroads into these areas,

(c) the Kitimat development of the Aluminum Co. of Canada,

(d) the huge hydro projects in most of the Provinces, but particularly those in Ontario and Quebec,

(e) construction of schools, hospitals, roads and subways by the major cities in Canada.

14. The investment dealers performed an important function in financing these developments by selling securities to non-residents when this capital was required.

15. External sales of new issues by Provincial, Municipal and Corporate debt securities in the period 1956 - 1960 amounted to $2,861,000,000.

<u>Type of Security Sold in the United States</u>

16. There are three main types of securities sold in the United States:

(a) United States payment bonds and debentures of Provinces, Municipalities and Corporations,

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United States Payment Bonds and Debentures.

17. The type of security sold in the United States that produced the main source of capital funds was United States payment debt securities created for that market. Between 1954 and 1959 United States investors increased their holdings of Canadian debt securities, payable externally, by $1,469,000,000 as co pared to $301 million in securities payable in Canadian funds only. In addition to being payable in the United States these securities were free from all Canadian taxes. In most instances they were made legal for investment of insurance companies and other institutions, were rated by the various statistical services and were issued for a term and with callable features attractive to the market. The yield return was also favourable in relation to comparable securities issued in the foreign market.

Canada Payment Securities

18. These securities were issued mainly for the Canadian market but were purchased by non-residents when the Canadian market and the exchange rate made the yield return particularly attractive. Canadian payment bonds and debentures are not nearly as acceptable in the United States as securities payable in that country. Many institutions are unable to buy them under the laws of the various states and in addition, the buyer is required to take an exchange risk which he would ordinarily avoid.

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19. Canadian Government and Guaranteed bonds

of Canada were, until 1960 the only internal bonds free from Canadian withholding taxes and these securities were at times purchased extensively by non-residents.

Stocks

20. Although the sales of stocks to foreign countries are included in our tables as part of the trade with non-residents, Appendix J deals with this subject.

Main Purchasers of Securities in the United States

21. The main purchasers of Canadian debt securities in recent years are:

Life Insurance Companies

Pension Funds - both government and industrial

Savings Banks

Trust Departments of Banks

Charitable and Educational Funds

22. All non-resident insurance companies that write insurance in Canada are required to maintain in Canada a deposit of securities equal to their liabilities in Canada. Investment dealers, in many cases, sell securities to these companies for this purpose by direct calls to the Head Office of the company in the United States. The volume of securities sold for this purpose is substantial but in practically all instances, the actual money invested is generated by these companies in Canada and is part of the total savings of Canadians and does not affect our balance of payments position.

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Comments on the Importance of Certain Factors on the Trade in Canadian Securities with Foreigners

Exchange Rates

23. The yearly high and low value of the United States dollar in Canada between 1951 and 1961 is shown in Exhibit 3.

24. The greatest flow of capital to Canada took place when the Canadian dollar was at a substantial premium. This would appear to indicate that the exchange value of the Canadian dollar was mainly the result rather than the cause of the capital flow.

25. In 1950 and early 1951 the United States dollar was at a fixed premium of approximately 10 per cent. At that time there was a good deal of speculation that the Canadian dollar would advance in price and foreigners bought large quantities of Canadian securities. The change to a free rate in 1951 was definitely influenced by the capital movement.

26. In June 1961, the Government announced its intention of taking action to move the value of the Canadian dollar to its "appropriate" level. The value of the Canadian dollar immediately started to decline and recently has fluctuated between a 3 - 5 per cent discount.

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bonds have always been higher than comparable United States issues from 1950 onward. As a result, Canadian issuers were able to sell securities payable in United States funds in the United States at yield rates which appeared to be more attractive than comparable rates in Canada. In fact, this condition exists today but mainly because of Government persuasion, Canadian issuers are confining their offerings to the Canadian market. (See Exhibit 5).

28. It is interesting to note as well that since 1950, the year 1955 was the only year in which Canada actually repatriated more of its securities abroad than it sold abroad and this was the year in which the spread in yield in favour of Canadian securities got to a relatively low level.

29. It should also be pointed out that yields on debt securities were probably lower in Canada between 1950 and 1959 than they would have ordinarily been because of the large volume of security sales in the United States.

Legislation and Tax Factors

Legislation in the Foreign Country

30. It is only in recent years that various States in the United States have made certain Canadian securities legal for the investment of insurance companies, banks and other funds. The ability to sell large quantities of securities in the United States depends on the extent to which they are legal for such institutions.

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Legislation in Canada

31. In the period from 1951 to 1959 Canadian laws favoured foreign investors. External payment Canadian bonds and Canadian Government internal bonds were free of all Canadian withholding taxes.

32. In late 1960 and subsequently, certain actions were taken pertaining to Government policy that curtailed foreign sales of securities.

33. These included:

(a) The suggestion by inference in the budget speech of December 1960 that Canadian borrowers finance their requirements in Canada,

(b) The exemption from Canadian withholding taxes was withdrawn from external payment and Canadian government internal bonds, issued after December, 1960,

(c) The Government policy to reduce the foreign exchange value of the Canadian dollar.

34. Some other events that caused uneasiness amongst foreign investors and indirectly reduced sales were:

(a) Federal Budgetary deficits,

(b) Controversy over the Governor of the Bank of Canada,

(c) The manner in which the British Columbia Electric Company was acquired by the Province of British Columbia.

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35. The Government suggestion that Canadian borrowers finance their requirements in Canada was

particularly effective in reducing sales because since that time there have been practically no new issues of foreign payment bonds sold by the Provinces of Municipalities.

36. The imposition of the withholding tax on external payment bonds could be having, and will have, a great effect on the volume of sales to non-residents. Among the largest buyers by volume of the highest grade external payment bonds in the past have been government and industrial pension funds, savings banks and fraternal organizations. These institutions pay little or no tax in their own country but they are not exempt from the Canadian withholding tax. The burden of this withholding tax would reduce substantially the yield return on new issues of Canadian securities and, as a consequence, these institutions are no longer buyers of Canadian securities that are subject to this tax.

37. It is probably too early for statistics to show the long term effect that these factors will have on foreign investment but net sales of securities were substantially reduced in 1960 and 1961. In addition, there was a marked change in the category of investment. Foreign direct investment in Canada produced substantially more capital than net sales of securities. In the period 1956 to 1959 the opposite was the case.

Conclusion

38. In the years of great expansion in Canada when the savings of the country were insufficient to provide the necessary capital and Canadian industry

Municipalities.

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38. In the years of great expansion in Canada

the capital goods, the investment industry went outside the country and sold securities to foreigners. It was shown that Canada had a good climate for foreign investment because of the character of the people, the sound Government policies and generally favourable economic conditions which indicated substantial growth.

39. As a result, foreign legislative bodies approved of and institutions accepted Canadian securities that were designed for the various markets and indicated their willingness to buy on a continuing basis. There is no doubt that the funds provided, increased the standard of living and wealth and the continuance of a flow of funds to Canada for productive purposes would undoubtedly create more wealth.

40. In the last two years at least, partly because of government legislation and action, thenet inflow of foreign capital has been reduced. Nevertheless, the post-war trend of an increase in the relative importance of equity as against debt, reflecting the increase of direct investment has been intensified, carrying with it greater foreign ownership and control of Canadian business.

41. We are in accord with the policy that Canada should use its domestic resources to finance capital formation by using its own plant and labour to the utmost, providing at the same time, the standard of living of the population is being increased to the greatest extent possible.

42. As long as Canada continues to have a deficit of international payments on current account,

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42. As long as Canada continues to have a deficit of international payments on current account,

funds must be provided from foreign sources.

Recommendations

43. Financial policy in Canada should be directed towards the following:

> To the extent that it is necessary or desirable to import capital from foreign countries, Government policy should be such that it favours the purchase by foreigners of debt securities rather than equity investments of all kinds.

44. If effectively pursued, such policies would contribute to an increasing Canadian participation in our economic development and to a growing ownership of this nation's industry and resources.

--o--

[illegible]

[illegible]

[illegible]

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GROSS NATIONAL PRODUCT
and
USE OF DOMESTIC AND FOREIGN RESOURCES
in
GROSS CAPITAL FORMATION IN CANADA

(Dollar amounts expressed in billions)

Year	G.N.P. at Market Prices	Gross Capital Formation	% of G.N.P.	Net Use of Domestic Resources	Net Use of Foreign Resources	Foreign Resources as % of Gross Capital Formation
1946	$ 11.85	$ 2.0	16.9%	$ 2.2	$ -.2	- %
1947	13.17	2.8	21.3	2.6	.2	7.1
1948	15.12	3.2	21.2	3.3	-.1	-
1949	16.34	3.6	22.0	3.5	.1	2.8
1950	18.01	4.5	25.0	3.8	.6	13.3
1951	21.17	5.7	26.9	4.8	.9	15.8
1952	24.00	6.0	25.0	5.6	.4	6.7
1953	25.02	6.6	26.4	5.4	1.2	18.2
1954	24.87	5.6	22.5	4.4	1.2	21.4
1955	27.13	6.6	24.3	4.9	1.7	25.8
1956	30.59	9.1	29.7	6.7	2.4	26.4
1957	31.91	8.9	27.9	6.3	2.6	29.2
1958	32.87	8.0	24.3	6.0	2.0	25.0
1959	34.86	8.7	25.0	6.2	2.6	29.9
1960	35.96	8.5 p	23.6	6.3	2.2 p	25.9

p - preliminary

Source: - Dominion Bureau of Statistics: 67-201

Population Census of Canada as at June 1st		
1951	....	14,009,429
1956	....	16,080,791
1961	....	18,238,247

* * * * * * * *

Exhibit 2

SELECTED NON-RESIDENT CAPITAL TRANSACTIONS
and
CURRENT ACCOUNT BALANCES FOR CANADA

1946 - 1961

Year	Canadian Current Account Balance of International Payments (1)	Foreign Direct Investment in Canada	Net New Issues of Canadian Securities	Net Increase in Foreign Holdings of Canadian Portfolio Securities	As % of Net New Issues
	(millions of dollars)				
1946	+ 363	40	28	- 127	--
1947	+ 49	61	- 84	- 282	--
1948	+ 451	71	168	39	23.2
1949	+ 177	94	64	- 34	--
1950	- 334	222	388	255	65.7
1951	- 517	309	157	265	168.8
1952	+ 164	346	976	133	13.6
1953	- 443	426	983	158	16.1
1954	- 432	392	972	191	19.7
1955	- 698	417	1849	- 45	--
1956	- 1366	583	1588	725	45.7
1957	- 1455	514	2279	757	33.2
1958	- 1131	420	3048	607	19.9
1959	- 1504	550	2281	650	28.5
1960	- 1217 p	645 p	1964	246	12.5
1961	- 989 p	420 p		303	

Notes: (1) + indicates surplus
- indicates deficit

(2) See Exhibit 4 for detailed account of transactions for years 1956 to 1961.

p preliminary

Sources: Dominion Bureau of Statistics 67-201
Bank of Canada Statistical Summary

Exhibit

COMPARISON OF YIELDS
ON
SELECTED CANADIAN AND UNITED STATES GOVERNMENT SECURITIES
IN CURRENCY OF PAYMENT

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Govt. of Canada 2 3/4% Jan. 15. 1967/68 (1)											
(a) High	3.48	3.63	3.63	3.59	3.42	4.01	4.81	4.52	5.37	5.55	4.75
(a) Low	2.98	3.47	3.47	2.92	2.81	3.24	3.66	3.31	4.45	4.09	4.12
U. S. Govt. 2 1/2% Dec. 15, 1963/68											
(a) High	2.71	2.73	2.73	2.66	2.98	3.49	3.93	3.94	4.90	4.97	4.20
(a) Low	2.31	2.53	2.53	2.33	2.60	2.78	2.99	2.66	3.80	3.46	3.53
Yield Spread in Favour of Canadian Issue											
(b) Maximum Spread	.57	1.03	1.01	.99	.58	.66	1.06	.87	.99	1.13	1.18
(b) Minimum Spread	.44	.76	.58	.40	.01	.35	.33	- .09 (2)	.34	.23	.07
Govt. of Canada 3 1/4% Oct. 1, 1979 (1)											
(a) High				3.26	3.44	3.90	4.35	4.42	5.30	5.42	5.20
(a) Low				3.22	3.13	3.30	3.79	3.78	4.41	4.63	4.77
U. S. Govt. 3 1/4% June 15, 1978/83											
(a) High				2.93	3.01	3.39	3.71	3.88	4.41	4.48	4.11
(a) Low				2.58	2.71	2.88	3.22	3.06	3.84	3.70	3.70

- continued

Exhibit 3 - continued

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Yield Spread in Favour of Canadian Issue											
(b) Maximum Spread				.61	.57	.59	.94	.79	1.20	1.39	1.41
Minimum Spread				.56	.22	.36	.36	.25	.50	.87	.73
Exchange Value of U.S. Dollar in Cdn. Currency											
High	7 5/16P	1 1/8P	7/32D	1 1/4D	1/16P	1/32D	1 3/8D	27/32D	1 13/16D	3/16D	4 3/8P
Low	1 3/16P	4 1/8D	3 1/8D	3 21/32D	3 17/32D	4 11/32D	5 25/32D	4 1/4D	5 7/16D	5 1/16D	1 3/4D

Notes: (1) Payable in Canadian currency
(2) On September 3rd, Cda's. 2 3/4/68 yielded 3.59% as against 3.68% for U. S. 2 1/2/68

Source: Compiled by the Investment Dealers' Association of Canada from figures extracted from Bank of Canada Statistical Summary.

(a) Figures shown for years 1951-53 are from closing mid-market quotes for the middle Wednesday of each month, from which quotes the above highs and lows have been taken. Figures for 1954 and subsequent years are compiled from closing mid-market quotes each Wednesday of the year.

(b) The figures for yield spreads are calculated from the same sources as were used in (a) but represent the maximum and minimum spread in yield between the prices quoted for the two securities on any given Wednesday, without reference to the high or low points in actual yields.

* * * * * * * *

Exhibit 4

NON-RESIDENT TRANSACTIONS IN CANADIAN SECURITIES

1956 - 1961

Year	Category (1)	Net Transactions in Outstanding Securities	Sales of New Issues to Non-Residents	Retirements of Foreign-Held Securities	Net Capital Inflow from Transactions
		($ millions)			
1956	Government	6	9	83	- 68
	Provincial	- 11	224	15	198
	Municipal	2	112	18	96
	Corporate	14	252	20	246
	Total Bonds	11	597	136	472
	Stocks	188	70	5	253
	Total Securities	199	667	141	725
1957	Government	- 14	16	29	- 27
	Provincial	- 15	136	25	96
	Municipal	- 1	123	24	98
	Corporate	- 15	462	30	417
	Total Bonds	- 45	737	108	584
	Stocks	137	61	25	173
	Total Securities	92	798	133	757
1958	Government	20	76	25	71
	Provincial	- 18	168	45	105
	Municipal	- 1	148	30	117
	Corporate	- 1	242	42	199
	Total Bonds	-0-	634	142	492
	Stocks	88	43	16	115
	Total Securities	88	677	158	607
1959	Government	118	56	101	73
	Provincial	- 5	334	41	288
	Municipal	2	158	34	126
	Corporate	- 24	112	65	23
	Total Bonds	91	660	241	510
	Stocks	110	47	17	140
	Total Securities	201	707	258	650
1960	Government	49	31	58	22
	Provincial	- 8	102	51	43
	Municipal	4	135	35	104
	Corporate	- 42	153	100	11
	Total Bonds	3	421	244	180
	Stocks	49	26	9	66
	Total Securities	52	447	253	246

Exhibit 4 - continued

Year	Category (1)	Net Transactions in Outstanding Securities	Sales of New Issues to Non-Residents	Retirements of Foreign-Held Securities	Net Capital Inflow from Transaction
		($ millions)			
1961	Government	75	37	47	65
	Provincial	- 8	53	23	22
	Municipal	3	36	40	- 1
	Corporate	- 7	330	129	194
	Total Bonds	63	456	239	280
	Stocks	40	36	53	23
	Total Securities	103	492	292	303

Notes: (1) Bonds and Debentures include direct and guaranteed issues in each category

Source: Dominion Bureau of Statistics 67-201 and 67-002

* * * * * * * * * *

Exhibit 5

QUOTATIONS ON CANADIAN PROVINCIAL AND MUNICIPAL SECURITIES
IN CANADA AND THE UNITED STATES
(March 12th, 1962)

Market Quotations in United States on Securities Payable in United States Funds	Price	Yield	Market Quotations in Canada on Securities Payable in Canadian Funds	Price	Yield
* Province of Ontario 4 3/4% Bonds Due 1st February 1984	102 1/2	4.57%	Province of Ontario 5 1/4% Bonds Due 15th March 1982	100 3/8	5.22%
Quebec Hydro-Electric Comm. 5% Bonds Due 15th July 1984	105 1/2	4.60%	Province of Quebec 5 1/4% Bonds Due 1st April 1984	99 5/8	5.30%
* Metropolitan Toronto 5% Bonds Due 1st June 1979	105	4.58%	Metropolitan Toronto 5 1/2% Bonds Due 15th February 1982	101 1/2	5.38%

United States Funds quoted in Canadian dollars
@ 4 7/8% -- 4 15/16% Premium

* Issued prior to December 1960

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APPENDIX N

TAXATION

Contents — Page

APPENDIX H

TAXATION

Contents

The Taxation Portion of the Brief submitted by The Investment Dealers' Association of Canada

Introduction

1. In a complex and industralized economy such as we have in Canada, taxes are recognized as a major factor and instrument of economic policy. To indicate the importance of taxes, government revenue at all levels for 1960 represented approximately 28.7 per cent of Canada's gross national product, and of this, taxes provided about 82 per cent (See Exhibit A).

2. Government taxing and spending now occupies a prominent position on the economic landscape for a variety of reasons, and expenditures by governments at all levels have increased very greatly compared to the pre World War II era, most of such increase having taken place during a period of unprecedented economic expansion. Such spending, perhaps some of which has been made for reasons hinging more on political expendiency than on actual need, has had to be financed by increased revenues. To be more specific, in 1939 government revenue at all levels represented approximately 20 per cent of Canada's gross national product in such year, compared to the present level of about 29 per cent. On a percentage basis this is an increase of nearly 50 per cent. Furthermore, this percentage increase relates to a very greatly increased gross national product. On a dollar basis the increase is very much greater, the total revenue for 1939 by governments at all levels being approximately $1,110,000,000, compared to the figure for 1960 of

The taxation position of the brief submitted by The Investment Dealers' Association of Canada

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$10,306,000,000. In other words, on a dollar basis, the present requirement by governments at all levels is nearly ten times that of 1939. Expressed on a per capita basis, total revenue for 1939 by government at all levels averaged approximately $95 per person for the population in such year, but by 1960 this had risen to a figure of $560 per person; an increase of nearly 500 per cent. In all years studied, taxes provided in excess of 80 per cent of government revenue (See Exhibit A). Only by a reduction in government spending can taxes, the principal source of government revenue, be realistically and permanently reduced.

3. It is against this background of increased government spending and the present means of financing this spending, relying as it does largely upon our taxation structure, that we believe the tax policies currently existing in Canada must be critically examined.

4. The growth of an economy depends on an increasing demand for goods produced and services rendered. The willingness of consumers, businesses and governments to spend money for goods and services, leads to utilization of capacity or expansion of such capacity. Conversely,lack of spending leads, not only to reduced utilization of capacity, but to unemployment of individuals. This in turn fosters the trend towards state socialism, requiring greater expenditure by government for purposes that may tend to be unproductive.

5. To adjust for the fluctuations caused by either over-utilization or under-utilization of capacity, present day economic thinking seems to have accepted the

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5. To adjust for the fluctuations caused by either over-utilization or under-utilization of capacity, present day economic thinking seems to have accepted the

principle that governments, either directly or through controlled indirect operations (such as a Central Bank) should endeavour to alleviate such fluctuations. In an attempt to mildly suppress the economy during boom period, spending is discouraged by government, and to strengthen the economy during recession periods, spending is encouraged. We consider it desirable that governments, with moderation, use periods of economic expansion to reduce debt and generally strengthen the economic framework of the country in preparation for periods of recession, when deficit and debt financing may become necessary.

6. Today, the heavy tax "load", and the method of application of such taxes, is having a profound effect on our economy, and the appeal being heard from many sources (see Exhibit B) for a thorough examination of Canada's taxation system is most appropriate. It is particularly so in relation to the problem of using fiscal policy as an aid in regulating the severity of business cycles. It is even possible that, of the various alternatives open to government to raise money now required for public spending, a tax levied upon income, as opposed to other means of producing revenue, may be a less than satisfactory method and in many respects may be undesirable.

Basic Principles and Areas for Examination

7. Without restricting the area of study of our taxation system, we wish to express an opinion on some of the basic principles that need to be examined in any major tax study. These basic principles and the

[illegible]

attempt to mildly suppress the economy during boom period, spending is discouraged by government, and to strengthen the economy during recession periods, spending is encouraged. We consider it desirable that governments, with moderation, use periods of economic expansion to reduce debt and generally strengthen the [illegible] periods of recession, when deficit and debt financing [illegible]

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Basic Principles and Areas for Examination

7. Without restricting the area of study of our taxation system, we wish to express an opinion on some of the basic principles that need to be examined in any major tax study. These basic principles and the

areas in need of study are as follows:

i. A general simplification of the total taxation system which would result in a greater understanding of its operation along with increased ease of collection.

ii. A more equitable distribution of the tax load than is currently the case.

iii. Increasing use of indirect taxation in order to broaden the tax base.

iv. Greater use of the incentive approach in order to direct economic activity and individual endeavour, and to funnel savings into revenue and employment producing activities.

v. An examination and study of the taxation systems and practices of certain other countries that are experiencing problems similar to those currently being experienced in Canada in order to see how such problems have been met by other countries.

vi. A detailed study of the problems currently relating to various types of corporate surplus.

vii. The effects of double taxation, particularly as it relates to corporate dividends.

viii. The effect of the current tax structure on the types of financing

[illegible] are as follows:

i. A general simplification of the total taxation system which would result in a greater understanding of its operation along with increased ease of collection.

ii. A more equitable distribution of the tax load than is currently the case.

iii. Increasing use of indirect taxation in order to broaden the tax base.

iv. Greater use of the incentive approach [illegible] and individual endeavour, and to funnel savings into revenue and employment producing activities.

v. An examination and study of the taxation systems and practices of certain other countries that are experiencing problems similar to those currently being experienced in Canada in order to see how such problems have been met by [illegible].

vi. A detailed study of the problems [illegible] of corporate [illegible].

vii. The effects of double taxation, particularly as it relates to corporate dividends.

viii. The effect of the current tax structure on the types of financing

being carried out by Canadian corporations.

ix. Examination of the division between capital gains and income in order to define and differentiate more clearly between the two.

x. The ability of a taxpayer to obtain a tax ruling prior to a transaction, as is possible in other countries.

xi. The elimination of the current tax disadvantages to Canadian individuals in the development of oil and other natural resources as compared to the position of individuals in the United States operating in Canada.

xii. Finally, it is important that a tax system be evolved to encourage, as much as possible, the orderly development and expansion of the Canadian economy for the benefit of all Canadians.

Taxation Studies Currently in Progress

8. We fully appreciate the long and arduous task involved in any major study of the existing Canadian tax structure and for this reason we believe that those undertaking any such study should avail themselves of prior studies on taxation in Canada.

9. At the present time Queen's University, Kingston, sponsored by the Canadian Tax Foundation, is in the process of carrying out a study of the level and structure of taxation in Canada, emphasizing the effects of changes in taxation on the economic growth of Canada.

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ii. [illegible]

capital gains and income in order to define and differentiate more clearly between the two.

x. The ability of a taxpayer to obtain a tax ruling prior to a transaction, as is possible in other countries.

xi. The elimination of the current tax disadvantages to Canadian individuals in the development of oil and other natural resources as compared to the position of individuals in the United States operating in Canada.

xii. Finally, it is important that a tax system be evolved to encourage, as much as possible, the orderly development and expansion of the Canadian economy for the benefit of all Canadians.

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This study is to be completed not later than September 30, 1964.

10. The scope of the Queen's University study is extremely broad and encompasses many, although by no means all, of the areas that we believe should be examined, and we suggest that the results of this particular study on taxation should be carefully considered.

The Need for a Comprehensive Study of the Canadian Tax Structure

11. It is our opinion that a complete investigation of the working of the Canadian tax structure today is essential in order to provide the proper emphasis on the direction in which the Canadian economy should be moving in a world environment which is now so different to that which existed prior to World War II. To indicate this change, at the present time approximately 56 per cent of Canadian exports (by dollar volume) are now being made to the United States as compared to only about 33 per cent prior to World War II. In this same period exports to Great Britain declined to approximately 17 per cent from over 40 per cent of the total (see Exhibit C). These fundamental and basic changes would in themselves, we believe, warrant a detailed investigation of the present Canadian tax system.

12. In addition, recognition of the trend towards the formation of large economic blocks is of equal importance in judging the suitability of Canada's present tax structure. The United States represents one

of these major blocks and, as a result of its proximity, its influence has been one of the major factors affecting the direction in which the Canadian economy has tended to move over the years. This influence may not be in the best long term interests of Canada. More recently the formation of the European Common Market represents the creation of another major block and, within a short period of time, the consolidation and forward momentum of this block may well affect Canada's exports to the countries forming this block.

13. In view of the above changes that have taken place and the possibility of greater changes in the near future, and as the present Canadian tax structure was formulated under conditions very different to those existing today, we respectfully submit that a thorough review of the Canadian tax structure is long overdue and is essential for continued Canadian prosperity.

General Comments and Factors Meriting Examination

Simplification of the Tax System

14. In our discussions with various tax authorities we have encountered the apparently general opinion that the Canadian tax structure, as it now stands, does not compare too unfavourably with the tax structures of other major industrialized countries with regard to simplicity and fairness to the individual. Nevertheless, in view of Canada's position in the world today, such a fact we believe does not state the case adequately and, in our opinion, taxes in Canada are high and not always easy to determine.

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The present patchwork of our tax laws is complicated and results in too much effort being utilized in tax avoidance. In connection with income, the thin line between ordinary income and capital gains is often the subject of confusion and dispute. While we appreciate that it may be difficult to avoid a complicated tax structure in a modern industrial state, we nevertheless believe a determined effort should be made to simplify the operation of the tax system as much as possible. The simpler the taxation system, the easier it will be for individuals and business to make decisions without undue emphasis being placed on the tax consequences. It will also be easier to collect taxes on an economical basis.

15. The complications resulting from the provisions of the Canadian Income Tax Act are frequently referred to as providing considerable employment to the legal and accounting professions.

A more Equitable Distribution of Taxes

16. In the relatively brief time available to us to examine the Canadian tax structure we have been impressed by the lack of incentive planning in the tax structure, along with the degree of discrimination that exists against certain segments of the productive population. Examples of inequities are to be found in the various forms of double taxation as income is funnelled through corporate channels to the investor. Another much discussed and little understood example of inequitable distribution of the tax load is that of the agreement among a community of individuals, trading

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amongst each other, to reduce their net incomes (and, therefore, their taxable incomes) through the exchanges of goods and services at prices below the then current market prices. Examples of the formal organization of such groups or communities trading among themselves are the phenomena known in Canada as co-operatives or credit unions. Quite apart from whether or not these organizations qualify under the Income Tax Act as taxable or tax-exempt (and it has been widely thought that co-operatives are not taxable whereas in fact most of them are taxable), the fact is that such organizations, by expressly reducing their taxable incomes and thereby failing to contribute their fair share of the tax load, illustrate another weakness in the fabric of our income tax structure.

17. It is our belief that a modest reduction in the higher marginal rates of personal taxation would be a constructive move and would increase personal incentive and initiative and would at the same time have an almost negligible effect on the revenue of the government. While of course there are always many exceptions, generally speaking we believe that such high marginal rates of personal taxation tend to stifle incentive for hard work and ideas. We question, for example, whether it is right and just for an individual taxpayer to be taxed at a higher rate than the largest Canadian corporations. The highest marginal rates of personal tax (which rise to as high as 80 per cent at the top level) contribute little in relation to the total personal tax dollars collected. If, for instance, the

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highest rates of personal tax were limited to 50 per cent (assuming all other rates were to remain as at present), the total loss of revenue to the government would be in the neighbourhood of around $10,000,000, or substantially less than one per cent of the total personal tax collected. All present trends point to increased political demands on government at all levels to increase public spending for such collective goals as counter-cyclical fiscal policy, education and social welfare. It is obvious that an excessively high rate of income tax tends to decrease the enthusiasm of a high income earner for hard work. The productivity of such a high income earner tends, as a result, to decline as income rises.

18. In view of Canada's position, balanced between two hugh economic blocks, it is our opinion that it is more important than ever before to encourage and foster within the country individuals having a high degree of ability and to assure that their financial rewards will be greater than is currently the case. This is especially true in certain lines of endeavour, such as the professions and some segments of the service industries, where any material amount of compensation except through salary is essentially impossible.

Use of Indirect Taxation

19. We are of the opinion that serious consideration should be given to broadening the tax base. For the year 1959, of the approximately 4,200,000 personal income taxpayers in Canada, approximately 4,000,000 -- or over 95 per cent -- paid less than the

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average rate that would have had to be levied against all taxable personal income in order to have collected the same amount of revenue. Such average rate of tax was approximately 17½ per cent on taxable personal income assessed. The approximately 200,000 taxpayers (less than 5 per cent of the total) who paid more than such average rates provided (for the year 1959) over $500,000,000 out of the total from all taxpayers of approximately $1,600,000,000. In other words, less than 5 per cent of the taxpayers were required to pay more than 30 per cent of the total personal income tax collected in order that more than 95 per cent of personal income taxpayers could pay less than the average rate of tax (see Exhibit D).

20. If the revenues of the government are to be increased substantially, other than through increased receipts as a result of economic expansion, and without hampering the means by which growth is attained, then it is our belief that this will have to be carried out by broadening the tax base. One of the most practical methods of broadening the tax base is through a greater use of indirect taxation and we believe this approach deserves special investigation.

21. A higher sales tax and/or a sales luxury tax on all goods and services might be implemented to the end that both corporate income taxes and personal income taxes might be greatly reduced. It is our suggestion that such a sales tax would be easier and less costly to collect than the present system of income tax, due to being based on the act of a sale

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which is easily established. Further, a high sales tax concept would tend to encourage personal saving which would be available for investment in the development of Canada. Under the present personal income tax concept, personal savings are taxed.

22. With regard to the broadening of the tax base, we have also been impressed by the fact that many individuals and groups receive the fruits and benefits of Canadian expenditures, but do not pay their full share for these benefits, although they are well able to do so. For example, it appears to us that the present income tax structure is in many ways inadequately related to the important and financial power of institutional, mutual and other similar corporate entities, together with co-operative entities mentioned earlier, and such corporations may not at this time be bearing a fair proportion of the tax burden. In view of this possible loss of revenue to the government, which results in an added tax burden for other taxpayers, we believe a thorough study should be made of the special tax considerations currently enjoyed by certain corporate entities.

To Encourage Economic Acitivity Through the Use of Tax Incentives

23. Although all taxation is punitive and acts as a disincentive, nevertheless by varying the emphasis of the tax burden, economic activity and human endeavour can be encouraged to flow in certain directions considered to be desirable. This function of the taxation system in influencing economic objectives by

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providing direction is one which we believe requires much study. In the consideration of Canada's current and potential problems several areas are indicated where activity and effort might well be encouraged through a positive use of the tax structure to achieve and encourage a strong sense of direction. Particularly is there a need to increase Canadian exports, especially those of manufactured or semi-manufactured goods, and to encourage their distribution throughout a greater number of trading areas. Also of imminent concern is the need to provide for the employment of a labour force that is expanding at a rate considerably in excess of that at which it can be absorbed by existing industry. Neither of the above mentioned problems lend themselves to any easy solution but both requires immediate attention. In our opinion, one method of applying the incentive necessary to encourage activity to move in the direction in which these problems can be solved, or at least alleviated, is through allowing industry to charge depreciation in excess of 100 per cent under certain conditions. An incentive of fairly large proportions must be granted to industry to assure that movement in the desired direction actually will take place. We commend the thinking that under certain conditions industry might be permitted to charge depreciation of as much as 150 per cent to 200 per cent on certain of their assets. In connection with the matter of depreciation, it is interesting to note that Canada continues to use the more complicated reducing balance method of depreciation, while Great Britain has

reverted to the simpler straight line method. This we believe to be another area which requires study.

Comparison of Canada's Tax System to Other Countries

24. A number of countries, such as Australia, New Zealand, South Africa and the Scandinavian countries, to mention a few, have many of the same basic problems that affect Canada at the present time. In some of these countries, as in Canada, exports of a small number of primary natural resource commodities are extremely important from the point of view of over-all national prosperity. We believe that consideration should be given to the way in which these countries have adapted and oriented their tax structure in order to suit conditions which bear a high degree of similarity to conditions in Canada. These tax structures should also be examined to find out if and what tax incentives are provided to encourage the formation of a strong and prosperous secondary industry. Other countries, such as Sweden, are popularly known as "welfare states" and some examination should be made as to the financing of these welfare benefits. We have noted with interest that the Swedish government appears to be giving increased recognition to the need to broaden the tax base by the recent increase in their national retail sales tax. Mention has already been made herein of the desirability of broadening the tax base in Canada.

Tax Problems Related to Corporate Surplus

25. Problems relating to corporate taxation are in many respects more difficult of satisfactory solution than those relating to personal taxation. One

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of the major corporate tax problems existing today concerns the handling of the various types of corporate surplus for taxation purposes. We understand that a great deal of consideration has been given to this problem by the Department of Finance in Ottawa. While Section 95 and later Section 105 of the Income Tax Act gave some initial relief and encouraged surplus distribution, these sections are unfortunately now relatively cumbersome and ineffective. This has resulted in what we consider to be a wasteful expenditure of time and energy in legal manoeuvres to avoid the current restrictions governing corporate surpluses. We do not wish to suggest that we have any solution for this highly complex problem but we do believe that it might be fruitful to pursue thinking which would result in a basic corporate tax at a fixed rate with a further flat tax being made at the corporate level on all distributions to shareholders, such distributions then being tax free in the hands of the shareholder. We have not been able to follow such a proposal through to its logical conclusion in order to assess all the effects that it would have throughout the economic system. However, it is our understanding that this type of tax is used in a number of countries and the results of its practical operation should be worthy of study.

The Effects of Double Taxation

26. The dividend tax credit is a most forward and progressive piece of fiscal thinking on the part of government. This legislation was originally passed for the purpose of relieving the effects of double taxation

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on the corporate dollar paid out in the form of dividends to shareholders. In 1953, when this dividend tax credit was increased to its present level of 20 per cent, it was also stated that an additional purpose was to encourage Canadians to invest in Canadian equities.

27. While the dividend tax credit has gone a long way in relieving the effect of taxing twice the same corporate dollar paid out in dividends, the relief has nonetheless not been completed and it should be recognized that many shareholders continue to carry more than their fair share of the tax burden.

The Taxation Effect on Financing

28. The use of the dividend tax credit has been successful in encouraging Canadians to invest in Canadian equities as opposed to investing in foreign equities. However, such tax credit has had little apparent effect on encouraging corporations to finance through the issue of equity rather than debt securities, and if this is to be accomplished it would seem that some incentive will have to be given at the corporate level as well as to the shareholder.

Differentiation Between Income and Capital Gains

29. Undoubtedly in any full study of the existing Canadian tax structure the question of the advisability of instituting a capital gains tax will arise. We have attempted to keep an open mind on this matter of the taxation of capital gains. Such a tax has been in operation in the United States for some years and currently a speculative gains tax is being considered in Great Britain. At the present time in Canada both

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the operations of business and of individuals are frequently made more difficult in that there are circumstances under which it is difficult to determine whether such operations are in the area of income or in that relating to capital gains. We realize that the differentiation between these two areas is frequently exceedingly difficult but a more precise definition of each would undoubtedly be of great assistance. We have found no support for a capital gains tax as it exists in the United States, nor do we support such a tax ourselves. Taxation of capital gains causes at times severe market dislocations, as individuals and corporations sell for the purpose of establishing capital losses to apply against capital profits. Such artificial effects on the market are not in the public interest. Furthermore, such a tax has the disadvantage of having a high cost of calculation and collection. The requirement of the Canadian economy for continuing and substantial growth in which eve increasing quantities of equity capital is essential indicates that any capital gains tax would be inadvisable and not in the best interests of Canada.

Advance Tax Rulings

30. In conjunction with the problem of differentiating between capital gains and income, as well as in connection with such other problems as those relating to corporate surpluses, we believe thorough study should be given to enabling a taxpayer to obtain a tax ruling prior to completion of a transaction. This is common practice in the United States and the adoption

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of such a policy in Canada would contribute greatly to the elimination of much of the present confusion involved in many business transactions.

The Elimination of Tax Disadvantages in Development of Canada's Natural Resources

31. The unfavourable position of individuals in Canada who are engaged in the exploration for oil and gas natural resources in Canada, compared to the position of individuals in the United States operating in Canada, is well known and it is believed that numerous submissions have been made to the Department of Finance and Income Tax Department relating to this unfavourable treatment. In effect the United States tax laws permit an individual to write off, against other taxable income, losses incurred in the development of such natural resources. The Canadian tax law does not permit the Canadian individual this type of write-off and it may well be due to this reason that such a high percentage of such Canadian natural resources are foreign controlled. While we do not agree or disagree with these laws as they are applied in the United States, the effect of the Canadian law has not been beneficial to Canada, and in fact we believe it to have beer harmful.

Revision of the Tax System for the Orderly Growth of the Economy

32. Perhaps one of the most distressing of all the features that can be attributed to the present tax structure is that in a period when the need for fiscal controls as an aid in regulating the economy is pronounced, the use of our tax structure as a fiscal

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agent seems to be impractical from a political point of view. Governments have been prepared to raise taxes in boom years as a brake against inflationary pressures, but have been less prepared to lower taxes during periods of reduced economic activity. It seems likely that because of its lack of political popularity, such a fiscal weapon, effective as it might prove, will rarely ever be used properly or quickly enough, whether for the purpose of stimulation or suppression. The extensive use of indirect taxation would permit rapid controllable changes in our taxation system.

33. It has been our intention throughout this brief to point out numerous areas where we believe the current tax structure is hindering rather than promoting economic growth, and at the same time minimizing rather than maximizing government revenues. It has been impossible for us to ascertain in such a brief study where the solution to these problems lies. However, we do believe it essential that the tax structure be more closely linked with a national sense of direction and priorities. Thus we contend that an effort must be made to find a positive approach to taxation that will accomplish far more than the negative approach which currently is employed.

34. In order that many of our suggestions may be carried out, a sweeping revision of the present Income Tax Act will be required. We appreciate that many problems will be created in accomplishing this, such as the time and expense in examining our Income Tax Act in its entirety, and the possible nullification of many

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established legal decisions. Nevertheless, in consideration of the impact taxes have on Canada's economy, it appears essential that competent personnal should carefully study, and recommend revision in, our tax laws so as to assist in the continued development of Canada.

Conclusions and Recommendations

35. Any review of the tax structure of a complex industrialized society requires a detailed appreciation of the impact that taxes have on the economy; on long term economic development; and even on the formation of social attitudes and national outlook. In the time available for the preparation of this brief it has been impossible to approach the subject of taxation in the detail and depth which is needed, and which in our opinion is urgently required. Therefore, we have tended to confine our study of taxation in Canada to those areas where we feel a revision of the existing tax structure would be of greatest benefit to all Canadians and to express our conclusions in relatively general terms.

1. In general, we have concluded as follows:

i. Greatly increased government spending in recent years has necessitated greatly increased taxation. The political inclination for increased government spending seems likely to continue. We question whether the income tax path and our income tax structure is the best available means of meeting such

Paras. 1 to 6 incl.

structured legal decisions. Accordingly, in consideration of the impact taxes have on Canada's economy, it appears essential that competent personnel should carefully study, and recommend revisions in, our tax laws so as to assist in the continued development of Canada.

Conclusions and Recommendations

35. Any review of the tax structure of a complex industrialized society requires a detailed appreciation of the impact that taxes have on the economy; on long term economic development; and even on the formation of social attitudes and national outlook. In the time available for the preparation of this brief it has been impossible to approach the subject of taxation in the detail and depth which is needed, and which in our opinion is urgently required. Therefore, we have tended to confine our study of taxation in Canada to those areas where we feel a revision of the existing tax structure would be of greatest benefit to all Canadians and to express our conclusions in relatively general terms.

I. In general, we have concluded as follows:

1. Greatly increased government spending in recent years has necessitated greatly increased taxation. The political inclination for increased government spending seems likely to continue. We question whether the income tax path and our income tax structure is the best available means of meeting such — Paras. 1 to 6 incl.

continuing need for increased revenues.

ii. There are twelve specific areas that we feel merit intensive study. In addition , the reports of other studies merit consideration. Paras. 7 to 10 incl.

iii. Changes in conditions, particularly Canada's position in the world economy, raise the question as to whether a revised tax structure would not better suit Canada's economic needs. Paras. 11 to 13 incl.

iv. The simplification of the tax system, if possible, would be very desirable. Paras. 14 & 15

v. Inequities in the tax load suggest that the present income tax pattern is less than satisfactory and discourages incentive. Paras. 16 to 18 incl.

vi. Indirect taxation should receive consideration as an alternative or partial alternative to income tax. Paras. 19 to 22 incl.

vii. An incentive method of applying whatever taxation is necessary should receive more attention. Para. 23

viii. Tax systems of other countries should be studied with a view to obtaining ideas for use in Canada. Para. 24

ix. Tax on corporate surplus should be revised to prevent present inequities and unnecessary corporate manoeuvres. Para. 25

x. The 20 per cent tax credit has considerable merit but the further

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ii. [illegible] — Paras. 7 to 10 incl.

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[illegible]

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v. Inequities in the tax load suggest that the present income tax pattern is less than satisfactory and discourages incentive. — Paras. 16 to 18 incl.

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vii. An incentive method of applying whatever taxation is necessary should receive more attention. — Para. 23

viii. Tax systems of other countries should be studied with a view to obtaining ideas for use in Canada. — Para. 24

ix. Tax on corporate surplus should be revised to prevent present inequities and [illegible]. — Para. 25

x. The 20 per cent tax credit has considerable merit but the further

reduction of double taxation in its various forms should be studied. Paras. 26 & 27

xi. Use of the dividend tax credit has provided little stimulus to corporate equity financing. Para. 28

xii. The requirement of the Canadian economy for continuing and substantial growth in which ever increasing quantities of equity capital is essential indicates that any capital gains tax would be inadvisable and not in the best interests of Canada. Para. 29.

xiii. The advantages of enabling a taxpayer to obtain a tax ruling prior to a transaction merit thorough study. Para. 30

xiv. Canadians are still at a disadvantage, compared to U.S. citizens and corporations, in respect to the development of their own oil and gas natural resources. Para. 31

xv. The use of the present tax structure as a fiscal control in the orderly growth of the economy has not been properly utilized. In this and other respects taxes must be more clearly linked to a national sense of direction. Paras. 32 to 34 incl.

2. Specifically we recommend the following:

i. In order to encourage a more rapid and sound development of the Canadian economy and to make

retention of [illegible] taxation in its various forms should be studied. — Paras. 26 & 27

xi. Use of the dividend tax credit has provided little stimulus to corporate equity financing. — Para. 28

xii. The requirement of the Canadian economy for continuing and substantial growth in which ever increasing quantities of equity capital is essential indicates that any capital gains tax would be inadvisable and not in the best interests of Canada. — Para. 29.

xiii. The advantages of enabling a taxpayer to obtain a tax ruling prior to a transaction merit thorough study. — Para. 30

xiv. Canadians are still at a disadvantage, compared to U.S. citizens and corporations, in respect to the development of their own oil and gas natural resources. — Para 31

xv. The use of the present tax structure as a fiscal control in the orderly growth of the economy has not been properly utilized. In this and other respects taxes must be more clearly linked to a national sense of direction. — Paras. 32 to 34 incl.

Specifically we recommend the following:

1. In order to encourage a more rapid and sound development of the Canadian economy and to make

more certain of its ability to absorb a rapidly increasing work force, we recommend the formation of a Select Committee to study and assess the entire tax structure of Canada with the objective of devising an improved taxation system better able to meet Canada's economic needs.

ii. We further recommend that before holding public hearings such Select Committee should carry out its initial deliberations on a confidential basis at the highest level in order to arrive at some definite conclusions under objective conditions.

iii. Furthermore, such Select Committee should be composed of highly qualified individuals having a broad working knowledge of the present tax structure with most emphasis being placed on its practical operation in business and in the economy as opposed to its legal and account operation. Such a committee should be composed primarily of representatives of Business form members of The Canadian Chamber of Commerce and Boards of Trade, representatives of Finance from members of The Investment Dealers' Association of Canada and The Canadian Bankers' Association, practical economists, and representatives of the Canadian Tax Foundation, and secondarily of members of the Legal and Accounting professions.

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[illegible]

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ii. We further recommend that before holding public hearings such Select Committee should carry out its initial deliberations on a confidential basis at the highest level in order to arrive at some definite conclusions under [illegible].

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EXHIBIT A

Total Government Revenue Expressed as a Percentage of Gross National Product

For Selected Calendar Years, 1929 to 1960

Year	Total Government Revenue: Federal $mm	Provincial $mm	Municipal $mm	All Governments $mm	Total Government Revenue as a Percentage of Gross National Product: Federal %	Provincial %	Municipal %	All Governments %	Total Taxes (all Governments) as a Percentage of Gross National Product %	Total Taxes (All Governments) as a Percentage of Government Revenues %
1929	399	200	366	965	6.5	3.3	6.0	15.7	13.1	83.4
1933	248	167	327	742	7.1	4.8	9.3	21.1	18.5	87.7
1939	459	295	356	1,110	8.1	5.2	6.3	19.7	16.7	84.8
1945	2,438	435	396	3,269	20.6	3.7	3.3	27.6	22.6	81.9
1946	2,602	519	417	3,538	22.0	4.4	3.5	29.9	24.9	83.3
1947	2,740	674	455	3,869	20.8	5.1	3.5	29.4	24.9	84.7
1948	2,677	812	511	4,000	17.7	5.4	3.4	26.5	22.1	83.4
1949	2,654	887	556	4,097	16.2	5.4	3.4	25.1	20.8	82.9
1950	2,965	978	624	4,567	16.5	5.4	3.5	25.4	21.0	82.7
1951	4,110	1,144	715	5,969	19.4	5.4	3.4	28.2	23.8	84.4
1952	4,626	1,136	809	6,571	19.3	4.7	3.4	27.4	23.0	83.9
1953	4,726	1,188	874	6,788	18.9	4.7	3.5	27.1	22.7	83.8
1954	4,528	1,246	945	6,719	18.2	5.0	3.8	27.0	22.3	82.6
1955	4,937	1,409	1,040	7,386	18.2	5.2	3.8	27.2	22.5	82.7
1956	5,578	1,598	1,163	8,339	18.2	5.2	3.8	27.3	22.6	82.8
1957	5,588	1,877	1,288	8,753	17.5	5.9	4.0	27.4	22.7	82.8
1958	5,321	1,979	1,416	8,716	16.2	6.0	4.3	26.5	21.7	81.9
1959	6,005	2,226	1,549	9,780	17.2	6.4	4.4	28.1	23.1	82.2
1960	6,280	2,354	1,672	10,306	17.5	6.5	4.6	28.7	23.4	81.5

Exclusive of inter-governmental transfers.

Includes Newfoundland for 1949 and subsequent years.

(All dollar figures stated in millions)

Source: NATIONAL ACCOUNTS, INCOME AND EXPENDITURE, D.B.S. (Dollar Figures Only).

EXHIBIT B

A few of the many comments by prominent Canadians on the Tax Structure

The high levels of taxation and the discouragement of incentive through the incidence of taxation impede the accumulation of risk-taking capital which will be necessary for our future growth.

Neil J. McKinnon,
President,
Canadian Imperial Bank of Commerce,
December 12, 1961.

There is, however, one aspect of our cost structure which will remain to plague us in spite of any progress we may make in our efforts to increase the efficiency of industry: I refer to our dis-incentive tax structure.

The burden of taxation lies not only in its absolute level, or even in its level relative to other countries, but in distortions induced by the uneven incidence of taxation. Greater incentive, and a greater national product, require a reform of our personal income tax, our corporate income tax, and our whole system of sales and excise taxes, with incentive as one, though by no means of course the only, object in view.

W. Earle McLaughlin,
President,
The Royal Bank of Canada,
January 11, 1962.

Counting all forms of taxes and exemptions, there is no question that the burden of taxation in Canada for the technical, professional and supervisory groups is

The high levels of taxation and the discouragement of [illegible] through the incidence of taxation impede the accumulation of [illegible] capital which [illegible] [illegible].

[illegible]
Canadian Imperial Bank of Commerce,
December 12, 1951.

There is, however, one aspect of our cost structure which will remain to plague us in spite of any progress we may make in our efforts to increase the efficiency of industry: I refer to our dis-incentive tax structure.

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[illegible]
The Royal Bank of Canada,
January 11, 1952.

[illegible] all forms of taxes and exemptions, there is no question that the burden of taxation in Canada for [illegible]

far more onerous than elsewhere on this continent. It is little wonder, therefore, that we continue to lose thousands of our best trained Canadian men and women to the United States and elsewhere, and are left with more and more untrained unemployables to look after. Unless there is more incentive for educated Canadians to stay here and for skilled outsiders to come to Canada and remain, it will be very difficult for us to have a buoyant and expanding economy. We shall lose the very people who could and would make Canada great. I suggest that this incentive should be provided by reducing our present tax loans so that they are definitely more favourable than elsewhere on this continent, <u>and when we have done that we should live within our means</u>. This, of course, implies that we should give much careful study and consideration to our present heavy burden of welfare costs and subsidies before increasing present commitments or embarking on new programs, as desirable as many of them seem to be.

E.G. Burton,
Chairman and President,
Simpsons, Limited
April 25, 1962.

Not only is there a need to restrain further increases in the already heavy tax burden, but a complete overhaul of our taxing systems is long overdue and I feel that this hould be undertaken without delay.

V.W. Scully,
President,
The Steel Company of Canada,
April 16, 1962.

[illegible]

[illegible]

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[illegible]

[illegible]

[illegible]

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[illegible]
[illegible]
The Steel Company of Canada
April 16, 1962.

Extract from The Financial Post, May 5, 1962.

NATION'S BUSINESS

Why Do They Avoid Issues that Count

To judge by the droves and herds of pollsters, admen, image-makers and assorted pseudo-scientific experts running the campaigns of all political parties, we are entering the final stages of the most researched and systematically organized general election in this country's history.

But it is remarkable, indeed, when the vast majority of adult Canadians have just filed tax returns that not a single politican has excoriated Canada's iniquitous and hare-brained tax structure, and that there is no significant public discussion of our vicious and punitive tax rates.

All major contenders for this country's highest offices have made national growth the central theme of their platforms -- yet all ignore the fact that the tax burden in Canada is one of the heaviest in the world. This is a preposterous state of affairs in a still-maturing nation and in one of the nations where individuals making their own decisions and left with their own money to invest in their plans and in their dreams can make for the greatest national growth.

Soak-the-rich taxation is no sensible basis for running the Canadian economy. We have slow national growth because we lack a high rate of capital investment. Yet very few can save when excessive tax rates leave little incentive and who will invest when worthwhile rewards are absent?

The old-time philosophical justification for violently progressive taxation is now greatly weakened. Three decades of punitive levies have scaled down old inherited fortunes and hastened the great sell-out of Canadian companies to foreign control. Few are without cars, fewer still without TV sets and fewer still without adequate food.

It is now the high earners who are being soaked -- precisely those Canadians who possess initiative, accomplishment and enterprise; the roots of our society. Indeed, taxation has so reached down, and inflation has so pushed up incomes that an important portion of the nation's resources of intelligence is spent devising schemes to minimize taxes, schemes that make no contribution to the productiveness of the economy.

What our tax system should do is unleash existing talent in Canada and attract new talent of all kinds. It should not punish enterprise. It should reward energy and innovation.

If Canada is to prosper as an independent nation and if we are to retain the benefits of individual initiative, then our leaders must find the political courage and the economic sophistication necessary to overhaul our whole approach to taxation and to have the courage to talk this in their campaign speeches.

Their present preoccupation with political gimmicks and giveaways will only lead to further economic slowdown and to the further weakening of that great central body of responsible Canadians which gives character to this nation.

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[illegible]

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EXHIBIT C

Merchandise Exports (Dollar Volume)

Millions of Dollars

	Total	To the U.K.	U.K. as % of Total	To the U.S.	U.S. as % of Total
1938	$ 848.6	$341.4	40%	$ 278.7	33%
1960	$5,405.0	$923.0	17%	3,043.0	56%

Sources: 1938 Trade of Canada - 1938 (D.B.S.).

1960 Canadian Statistical Review, March 1962. (D.B.S.)

EXHIBIT D

1959 Average Rates of Tax - Gross Income Classifications

Income	Less than $9,000	More than $9,000	Total
Number of taxable returns	4,076,921	165,569	4,242,490
Total income assessed	$ 14,850,205,000	$ 2,598,084,000	$ 17,448,289,000
Taxable income assessed	$ 6,895,993,000	$ 2,058,156,000	$ 8,954,149,000
Tax payable	$ 1,051,166,000	$ 528,875,000	$ 1,580,041,000
Average rate of tax (Tax payable as a percentage of taxable income assessed)	15.2%	25.7%	17.6%

Income	8,000 to 8,999	9,000 to 9,999
Taxable income assessed	$ 335,367,000	$ 249,198,000
Tax payable	$ 58,457,000	$ 44,737,000
Average rate of tax	17.4%	17.9%

Source: 1961 Taxation Statistics, Department of National Revenue

May 1962